93-1479

No. _____

In the Supreme Court

OF THE

United States

Supreme Court, U.S.
FILED
MAR 16 1994
OFFICE

OCTOBER TERM, 1993

CRUTTENDEN & COMPANY, TALLEY MCNEIL & COMPANY, INC., SUTRO & CO., INC., ROBERT C. CARTY, JR., SUN LIFE ASSURANCE COMPANY OF CANADA, SUN FINANCIAL GROUP, LOOMIS SAYLES & CO., DOES 1 THROUGH 100, INCLUSIVE,
Petitioners,

VS.

ROBERT A. LYNCH, BETTY LAVERNE LYNCH, individually and as TRUSTEES OF THE ROBERT A. LYNCH AND BETTY LAVERNE LYNCH FAMILY TRUST DATED MAY 30, 1979
Respondents.

On Petition for Writ of Certiorari to the Supreme Court of the State of California

PETITION FOR WRIT OF CERTIORARI

DAWN M. SCHOCK
Counsel of Record
JOHN R. LOFTUS
KEESAL, YOUNG & LOGAN
A Professional Corporation
Catalina Landing —
310 Golden Shore
Post Office Box 1730
Long Beach, California 90801-1730
Telephone: (310) 436-2000

Attorneys for Petitioners
CRUTTENDEN & COMPANY, TALLEY MCNEIL & COMPANY, INC., and ROBERT C. CARTY, JR.

GILBERT R. SEROTA
HOWARD, RICE, NEMEROVSKI, CANADY, ROBERTSON, FALK & RABKIN
A Professional Corporation
Seventh Floor
Three Embarcadero Center
San Francisco, CA 94111
Telephone: (415) 434-1600

Attorneys for Petitioner
SUTRO & CO., INC.

Bowne of Los Angeles, Inc., Law Printers (213) 627-2200

8 1 PP

QUESTION PRESENTED

Is the rule of law affirmed by the California Supreme Court — that alleged misrepresentations that certain contracts as a whole were formalities that did not affect respondents' legal rights are sufficient under the Federal Arbitration Act, 9 U.S.C. § 1, *et seq.* ('FAA"), to avoid arbitration — preempted by the rule established by this Court in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 87 S. Ct. 1801, 18 L. Ed. 2d 1270 (1967), that "fraud in the inducement of the arbitration clause itself" must be alleged in order to avoid an order compelling arbitration under the FAA?

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
OPINIONS BELOW	1
JURISDICTION	2
STATUTE INVOLVED	2
STATEMENT OF THE CASE	3
A. FACTS	3
B. PROCEDURE	4
ARGUMENT	5
I.	
REVIEW SHOULD BE GRANTED BECAUSE THE CALIFORNIA SUPREME COURT HAS DENIED ARBITRATION UNDER THE FAA IN DIRECT CONFLICT WITH DECISIONS OF THIS COURT, THE UNITED STATES COURTS OF APPEALS, AND OTHER STATE COURTS OF LAST RESORT	5
A. THIS COURT HAS INTERPRETED THE FAA TO LIMIT JUDICIAL FACT-FINDING TO ALLEGATIONS OF FRAUD DIRECTED SPECIFICALLY TO AN ARBITRATION CLAUSE AND REJECTED JUDICIAL INTERVENTION BASED UPON ALLEGATIONS OF FRAUD IN THE INDUCEMENT OF THE CONTRACT GENERALLY	5
B. THE UNITED STATES COURTS OF APPEALS AND NUMEROUS STATE COURTS OF LAST RESORT HAVE REJECTED ATTEMPTS TO UNDERMINE THE *PRIMA PAINT* DOCTRINE	6
C. THE OPINION IN THE CASE BELOW IMPROPERLY DENIES ARBITRATION UNDER THE FAA BASED UPON GENERALIZED ALLEGATIONS OF FRAUDULENT INDUCEMENT OF THE CONTRACTS AS A WHOLE, NOT FRAUD CLAIMS DIRECTED SPECIFICALLY TO THE ARBITRATION CLAUSES	9

TABLE OF CONTENTS

Page

1. Contrary to the Position of the California Courts, the Circuit Courts of Appeals Reject Challenges to Arbitration Based Upon the Allegations of a Failure to Read the Contract 10

2. Contrary to the Position of the California Courts, the United States Courts of Appeals Reject Challenges to Arbitration Based Upon the Allegation that the Broker Advised that the Contract was a Mere Formality that Would Not Affect Legal Rights and Did Not Advise of the Existence of the Arbitration Clause 12

3. Contrary to the Position of the California Courts, the United States Courts of Appeals Have Rejected the Notion that Allegations of Fraud in the Inducement Can be Directed at Both the Arbitration Clause and the Contract As A Whole 13

D. ALLEGATIONS OF A FIDUCIARY RELATIONSHIP DO NOT JUSTIFY THE COURT'S DEPARTURE FROM *PRIMA PAINT* DOCTRINE IN THE ABSENCE OF EXTRAORDINARY ABUSES OF THE RELATIONSHIP 14

E. THERE IS NO DISPUTE THAT FEDERAL LAW CONTROLS THE ISSUES DECIDED IN THE CASE BELOW AND PREEMPTS CONFLICTING STATE LAW 16

II.

REVIEW SHOULD BE GRANTED BECAUSE THE DECISION BELOW DEPARTS FROM AND SUBSTANTIALLY UNDERMINES THIS COURT'S STRONG ENDORSEMENT OF SECURITIES ARBITRATION 17

CONCLUSION 19

TABLE OF AUTHORITIES

Cases

	Page
Arnold v. Arnold, 920 F.2d 1269 (6th Cir. 1990)	7, 13
Bayma v. Smith Barney, Harris Upham & Co., 784 F.2d 1023 (9th Cir. 1986)	16
Bhatia v. Johnston, 818 F.2d 418 (5th Cir. 1987)	6, 15
Capital Income Properties-LXXX v. The Honorable R. Blackmon, 843 S.W.2d 22 (Sup. Ct. Tex. 1992)	8, 15
Cohen v. Wedbush, Noble, Cooke, Inc., 841 F.2d 282 (9th Cir. 1983)	11
David v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 440 N.W.2d 269 (Sup. Ct. N.D. 1989)	8
Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213, 105 S. Ct. 1238, 84 L.Ed.2d 158 (1985)	18
Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 20 Cal.App.3d 668, Cal.Rptr. 811 (1971)	11
Hamilton Life Ins. Co. of N.Y. vs. Republic Nat'l Life Ins. Co., 408 F.2d 606 (2d Cir. 1969)	7
Hercules & Co. v. Shama Restaurant Corp., 613 A.2d 916 (D.C. Ct. App. 1992)	8
In the Matter of the Arbitration Between Weinrott and Carp, 32 N.Y.2d (Ct. App. N.Y. 1973)	8
Jeske v. Brooks, 875 F.2d 71 (4th Cir. 1989)	7
Jones v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 604 So.2d (Sup. Ct. Ala. 1991)	8, 15
Lynch v. Cruttenden & Co., 18 Cal. App. 4th 802, 22 Cal. Rptr. 2d 636 (1993)	10
Macaulay v. Norlander, 12 Cal. App. 4th 1, Cal. Rptr. 2d 204 (1992)	10
Macchiavelli v. Shearson, Hammill & Co., 384 F.Supp. 21 (E.D. Cal. 1974)	16
Miller v. Drexel Burnham Lambert Inc., 791 F.2d 850 (11th Cir. 1986)	7

TABLE OF AUTHORITIES

CASES

	Page
Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 103 S. Ct. 927, 74 L.Ed. 2d 765 (1983) ..	17
N&D Fashions, Inc. v. DHJ Indus. Inc., 548 F.2d 722 (8th Cir. 1977)	7
Parr v. Superior Court, 139 Cal. App. 3d 440, 188 Cal.Rptr. 801 (1983)	10
Perez & Assoc. v. Welch, 960 F.2d 534 (5th Cir. 1992) ..	11, 14
Perry v. Thomas, 482 U.S. 483, 107 S.Ct. 2520, 96 L.Ed. 2d 426 (1987)	17
Pierson v. Dean Witter Reynolds Inc., 742 F.2d 334 (7th Cir. 1984)	11
Prima Paint Corp. v. Flood & Conklin Mfg. Co., 33 U.S. 395 S.Ct. 1801, 18 L.Ed. 2d 1270	i, 4, 5
Republic of Nicaragua v. Standard Fruit Co., 937 F.2d 469 (9th Cir.) (1991)	16
Riley v. Kingsley Underwriting Agencies, Ltd., 969 F.2d 953 (10th Cir.) (1991)	7
Rodriquez de Quijas v. Shearson/American Express Inc., 490 U.S. 477, 109 S. Ct. 1917, 104 L.Ed. 2d 526 (1989)	18
Rowland v. PaineWebber Inc., 4 Cal. App. 4th 279, 6 Cal. Rptr. 2d 20 (1992)	10, 16
Schacht v. Beacon Ins. Co., 742 F.2d 386 (7th Cir. 1984)	7
Sentry Sys., Inc. v. Guy, 98 Nev. 507 (Sup. Ct. Nev. 1982)	8
Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 107 S. Ct. 2332, 96 L.Ed. 2d 185 (1987)	16
South Carolina Pub. Serv. Auth. v. Great W. Coal, Inc., 437 S.E.2d 22 (Sup. Ct. S.C. 1993)	8
Statement Mach. Co. v. Alperin, 591 F.2d 234 (3d Cir. 1979)	7
Southland Corp. v. Keating, 465 U.S. 1, 104 S.Ct. 852, 79 L.Ed. 2d 1 (1984)	16, 17

TABLE OF AUTHORITIES

CASES

	Page
Sweet Dreams Unlimited v. Dial-A-Mattress Int'l, 1 F.3d 639 (7th Cir. 1993)	14
Teledyne, Inc. v. Kone Corp., 892 F.2d 1404 (9th Cir. 1990)	6, 14
Thayer v. American Fin. Adviser, Inc., 322 N.W.2d 599 (Sup. Ct. Minn. 1982)	8
Three Valleys Mun. Water Dist. v. E.F. Hutton & Co., 925 F.2d 1136 (9th Cir. 1991)	6, 14
Tonetti v. Shirley, 173 Cal.App.3d 1144, 219 Cal. Rptr. 616 (1985)	16
Union Mut. Stock Life Ins. Co. of Am. v. Beneficial Life Ins. Co., 774 F.2d 524 (1st Cir. 1985)	7
Volt Info. Sys. Inc. v. Board of Trustees of the Leland Standford Junior Univ., 489 U.S. 468, 103 L.Ed. 2d 488 (1989)	16
Vukasin v. D.A. Davidson & Co., 241 Mont. 126 (Sup. Ct. Mont. 1990)	8

Statutes

28 U.S.C. Section 1257	2
9 U.S.C. Sections 2 & 4	2

Rules

United States Supreme Court Rule 29.1	1

No. _____

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1993

CRUTTENDEN & COMPANY, TALLEY MCNEIL & COMPANY, INC., SUTRO & CO., INC., ROBERT C. CARTY, JR., SUN LIFE ASSURANCE COMPANY OF CANADA, SUN FINANCIAL GROUP, LOOMIS SAYLES & CO., DOES 1 THROUGH 100, INCLUSIVE,
Petitioners,

VS.

ROBERT A. LYNCH, BETTY LAVERNE LYNCH, individually and as TRUSTEES OF THE ROBERT A. LYNCH AND BETTY LAVERNE LYNCH FAMILY TRUST DATED MAY 30, 1979
Respondents.

On Petition for Writ of Certiorari to the Supreme Court of the State of California

PETITION FOR WRIT OF CERTIORARI

OPINIONS BELOW

The orders of the Superior Court of the State of California for the County of Ventura denying the petitioners[1] motions to compel

[1]Pursuant to United States Supreme Court rule 29.1, petitioner CRUTTENDEN & COMPANY reports no parent or subsidiary corporations, petitioner TALLEY McNEIL & COMPANY, INC. reports parent corporation Cruttenden & Company and no subsidiary corporations, and petitioner SUTRO & CO., INC. reports parent corporations

arbitration are not officially reported and are reproduced in the appendix ("App.") at pages 1a-4a.[2]

The order of the Second District Court of Appeal for the State of California affirming the denial of the petitions to compel arbitration is officially reported at 18 Cal. App. 4th 802 (1993) and is reproduced in the appendix at page 5a.

The order of the California Supreme Court denying the petition for writ of certiorari is not officially reported and is reproduced in the appendix at page 14a.

JURISDICTION

The order of the California Supreme Court denying the petitioners' petition for writ of certiorari was rendered on December 16, 1993. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257.

STATUTE INVOLVED

Sections 2 and 4 of the FAA, 9 U.S.C. §§ 2 & 4, are reproduced as follows:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to

---

John Hancock Freedom Securities, Inc. and John Hancock Mutual Life Insurance Co. and no subsidiary corporations.

[2]Originally, petitioners CRUTTENDEN & COMPANY and TALLEY McNEIL & COMPANY, INC. (collectively "Cruttenden") and petitioner SUTRO & CO., INC. ("Sutro") brought separate motions to compel arbitration (Superior Court of California, County of Ventura Case No. 119524). Petitioners then brought separate appeals which were consolidated for argument (Court of Appeal of California, Second Appellate Court District Case Nos. B065193 & B066610). Cruttenden and Sutro then brought a joint petition for writ of certiorari to the California Supreme Court (Case No. S035471).

> arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation any contract.

9 U.S.C. § 2 (1982).

> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court . . . for an order directing that such arbitration proceed in the manner provided for in such agreement. . . . The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. . . . If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof.

9 U.S.C. § 4 (1982).

STATEMENT OF THE CASE

A. FACTS.

The respondents, ROBERT A. LYNCH and BETTY LAVERNE LYNCH, individually and as TRUSTEES OF THE ROBERT A. LYNCH AND BETTY LAVERNE LYNCH FAMILY TRUST DATED MAY 30, 1979 ("respondents"), alleged, in part, securities fraud and breaches of fiduciary duty against the petitioners, securities brokerage firms and their employee, in the handling of their securities accounts. Throughout the life of the respondents' securities accounts at Sutro and then Cruttenden, the respondents signed 12 separate documents, each containing an agreement to arbitrate disputes concerning their accounts. Many of the arbitration clauses signed by the respondents were written in bold print and were positioned immediately before the signature lines where the respondents signed their names.

To avoid their contractual obligation to arbitrate, the respondents alleged in their complaint and in declarations in opposition to motions to compel arbitration: (1) that they were told they were signing agreements which did not affect their legal rights, (2) that they were not informed of the arbitration clauses, and (3) that they did not read the agreements before they signed them.

B. PROCEDURE.

The petitioners sought to compel arbitration based upon the FAA. Portions of the motions to compel arbitration indicating reliance upon the FAA are reproduced in the appendix at pages 15a-19a and 20a-23a. While the state courts of first instance recognized the conflict between state appellate courts' and federal appellate courts' interpretations of the FAA, they, nevertheless, felt that the state rule mandated the denial of the motions to compel arbitration. Portions of the transcripts of the hearings before the trial courts, which indicate the awareness of this conflict between the state and the federal rules are reproduced in the appendix at pages 24a-26a and 27a-42a.

The petitioners then argued before the Second District Court of Appeal that the interpretation of the FAA as set forth in this Court's decision in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 87 S. Ct. 1801, 18 L. Ed. 2d 1270 (1967), controlled and preempted any contrary state rules. The portions of the petitioners' briefs filed with the District Court of Appeal raising the federal question are reproduced in the appendix at pages 44a-48a and 49a-54a. The Second District Court of Appeal, however, distinguished the federal cases, applied California law and affirmed the trial courts' denial of the petitions to compel arbitration.

The petitioners then joined in a petition for review to the California Supreme Court, again raising the argument that the state court cases were in conflict with federal cases interpreting the FAA and were, thus, preempted. Review was denied. The portions of the petition for review to the California Supreme Court raising the preemption issue are reproduced in the appendix at pages 55a-61a.

ARGUMENT

I.

REVIEW SHOULD BE GRANTED BECAUSE THE CALIFORNIA SUPREME COURT HAS DENIED ARBITRATION UNDER THE FAA IN DIRECT CONFLICT WITH DECISIONS OF THIS COURT, THE UNITED STATES COURTS OF APPEALS, AND OTHER STATE COURTS OF LAST RESORT.

A. THIS COURT HAS INTERPRETED THE FAA TO LIMIT JUDICIAL FACT-FINDING TO ALLEGATIONS OF FRAUD DIRECTED SPECIFICALLY TO AN ARBITRATION CLAUSE AND REJECTED JUDICIAL INTERVENTION BASED UPON ALLEGATIONS OF FRAUD IN THE INDUCEMENT OF THE CONTRACT GENERALLY.

This Court provided the rule which governs this petition in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 87 S. Ct. 1801, 18 L. Ed. 2d 1270 (1967). In that case, the Court considered whether the issue of the enforceability of a contract alleged to have been fraudulently induced and which contained an arbitration provision was to be considered by a court or by arbitrators. The Court ruled that the matter was to be sent to arbitration. In so holding, the Court recognized that the arbitration clause is severable from the rest of the contract. The Court held:

> [I]f the claim is fraud in the inducement of the arbitration clause itself — an issue which goes to the "making" of the agreement to arbitrate — the federal court may proceed to adjudicate it. *But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally.*

Id. at 403-04 (emphasis added).

As is demonstrated in the following sections, the *Prima Paint* rule has been uniformly applied throughout the federal system. Challenges to contracts, such as those in the present case, which

are not specific to the arbitration clause must be compelled to arbitration under the FAA.

B. THE UNITED STATES COURTS OF APPEALS AND NUMEROUS STATE COURTS OF LAST RESORT HAVE REJECTED ATTEMPTS TO UNDERMINE THE *PRIMA PAINT* DOCTRINE.

Federal Circuit Courts of Appeals have preserved the distinction between generalized allegations of fraud directed to the entire contract and those challenges directed specifically to the arbitration clause. The Ninth Circuit repeatedly has ruled that in order for a "fraud in the inducement" challenge to be heard in court rather than in arbitration, the challenge must be "*separate* and *distinct* from any challenge to the underlying contract." *Teledyne, Inc. v. Kone Corp,*. 892 F.2d 1404, 1410 (9th Cir. 1990). In *Three Valleys Mun. Water Dist. v. E.F. Hutton & Co.,* 925 F.2d 1136 (9th Cir. 1991), the court said of the *Prima Paint* doctrine: "Under this analysis, a federal court may consider a defense of fraud in the inducement of a contract only if the fraud relates *specifically* to the arbitration clause itself *and not to the contract generally*." *Id.* at 1140 (emphasis added).

The other federal circuit courts of appeals are in accord with the Ninth Circuit's interpretation of *Prima Paint* and, thus, are contrary to the resolution of the issue reached by the California courts in the present case. In *Bhatia v. Johnston*, 818 F.2d 418 (5th Cir. 1987), for instance, a securities customer alleged in his complaint and in declarations in opposition to a motion to compel arbitration that he signed a customer agreement containing an arbitration clause at the instruction of his broker, that the broker did not explain the significance of the arbitration clause, and that the broker did not explain that the customer's legal rights under the agreement were different than they were under a previous agreement. *Id.* at 422 nn.4 & 5. The Fifth Circuit said of these allegations: "We are persuaded that Bhatia did not assert that the arbitration clause alone, as opposed to the customer agreement generally, was induced by the misrepresentations and actions of Johnston." *Id.* at 422.

The Seventh Circuit, in *Schacht v. Beacon Ins. Co.*, 742 F.2d 386 (7th Cir. 1984), emphasized that the "fraud in the inducement" challenge must refer solely to the arbitration clause in order to bypass arbitration:

> Appellant nowhere contends that the alleged fraud in the inducement applied *solely* to the arbitration clause. Its claim of fraud applies equally to all provisions of the contract. Thus, if the clause is sufficiently broad to encompass a claim of fraud in the inducement, the district court properly concluded that *Prima Paint* precludes the court from addressing that claim.

Id. at 390. *See also Union Mut. Stock Life Ins. Co. of Am. v. Beneficial Life Ins. Co.*, 774 F.2d 524, 528 (1st Cir. 1985) ("[t]here must be an independent challenge to the making of an arbitration clause"); *Hamilton Life Ins. Co. of N.Y., vs. Republic Nat'l Life Ins. Co.*, 408 F.2d 606, 610 (2d Cir. 1969) ("[i]llegality, fraudulent inducement, or repudiation of the principal contract does *not* operate to nullify an agreement to arbitrate"); *Statement Mach. Co. v. Alperin*, 591 F.2d 234, 238 (3d Cir. 1979); *Jeske v. Brooks*, 875 F.2d 71, 75 (4th Cir. 1989) ("[b]ecause the alleged defects pertain to the entire contract, rather than specifically to the arbitration clause, they are properly left to the arbitrator for resolution"); *Arnold v. The Arnold Corp.*, 920 F.2d 1269, 1278 (6th Cir. 1990) ("[t]he question presented . . . is . . . whether the . . . complaint contains a . . . claim of fraud in the inducement of the arbitration clause itself, *standing apart from the whole agreement* . . .); *N&D Fashions, Inc. v. DHJ Indus, Inc.*, 548 F.2d 722, 728 (8th Cir. 1977) ("[a]t most, N&D claims fraud in the inducement to enter the contract of sale, rather than fraud in the inducement to enter the agreement to arbitrate. Fraud of the first type does not affect the duty to arbitrate"); *Riley v. Kingsley Underwriting Agencies, Ltd.*, 969 F.2d 953, 960 (10th Cir.), *cert. denied*, 121 L. Ed. 2d 584 (1992) ("[a] plaintiff seeking to avoid a choice provision . . . must . . . plead fraud going to the specific provision"); *Miller v. Drexel Burnham Lambert Inc.*, 791 F.2d 850, 854 (11th Cir. 1986) ("[a]ppellant's claim bars arbitration only if it goes to the arbitration clause itself and not the whole contract").

While not as uniform in following the dictates of *Prima Paint* as the Circuit Courts of Appeals, many state courts of last resort likewise have rejected attempts similar to those presented in the present case to avoid contractual arbitration. In *Jones v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 604 So.2d 332 (Sup. Ct. Ala. 1991), the Supreme Court of Alabama noted that allowing allegations that a brokerage firm mailed a contract to its customer for signature without an explanation that the contract contained an arbitration clause to defeat a motion to compel arbitration would, in every case, allow "a skillfully crafted complaint" to avoid arbitration, "thus effectively eviscerating the FAA and circumventing the strong policy favoring arbitration." *Id.* at 336. *See also South Carolina Pub. Serv. Auth. v. Great W. Coal, Inc.*, 437 S.E.2d 22 (Sup. Ct. S.C. 1993); *Capital Income Properties-LXXX, et al. v. The Honorable Robert M. Blackmon*, 843 S.W.2d 22 (Sup. Ct. Tx. 1992); *Hercules & Co. v. Shama Restaurant Corp.* 613 A.2d 916 (D.C. Ct. App. 1992); *Vukasin v. D.A. Davidson & Co.*, 241 Mont. 126 (Sup. Ct. Mont. 1990); *Sentry Sys., Inc. v. Guy*, 98 Nev. 507 (Sup. Ct. Nev. 1982); *David v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 440 N.W.2d 269 (Sup. Ct. N.D. 1989).[3]

All of the federal appellate courts and many state courts of last resort, therefore, follow *Prima Paint* in requiring a "fraud in the inducement" challenge to arbitration to be directed specifically and solely to the arbitration clause in order to defeat a motion to compel arbitration.

---

[3] Other state courts of last resort, like the California Supreme Court, recognize exceptions to the *Prima Paint* doctrine in cases under the FAA for allegations of fraud in the inducement which refer to the contract generally rather than to the arbitration clause specifically. *See, e.g., In the Matter of the Arbitration Between Weinrott and Carp*, 32 N.Y.2d 190, 197 (Ct. App. N.Y. 1973) ("if the alleged fraud was part of a grand scheme that permeated the entire contract, including the arbitration provision, the arbitration provision should fall with the rest of the contract"); *Thayer v. American Fin. Adviser, Inc.*, 322 N.W.2d 599 (Sup. Ct. Minn. 1982) (language of the arbitration clause must indicate a specific intent to arbitrate fraudulent inducement claim).

C. THE OPINION IN THE CASE BELOW IMPROPERLY DENIES ARBITRATION UNDER THE FAA BASED UPON GENERALIZED ALLEGATIONS OF FRAUDULENT INDUCEMENT OF THE CONTRACTS AS A WHOLE, NOT FRAUD CLAIMS DIRECTED SPECIFICALLY TO THE ARBITRATION CLAUSES.

In responding to the petitioners' motions to compel arbitration below, the respondents made allegations concerning the circumstances surrounding their signing the agreements containing arbitration clauses. None of these allegations satisfy *Prima Paint*. A review of the respondents' references to the signing of the documents which were presented below indicates that all but one of the references unambiguously apply to the agreements generally, not to the arbitration clauses specifically. The only allegation which arguably could be interpreted to be specific to the arbitration clauses in either the complaint or the declarations is the allegation that the broker did not reveal the arbitration provisions to the respondents ("[t]he Lynches claimed they were not advised of the contents of the documents . . ."). (App., 6a-7a.) As is demonstrated below, however, the failure of the respondents to read their documents is not grounds to void the contracts.

All remaining allegations relating to fraud in the execution of the agreements refer to the contracts generally. *E.g.*, "MR. CARTY . . . told us . . . that he needed some 'form' documents signed in order to open the account. . . . He told me . . . that it was not necessary to read the documents since they simply effected an opening of the account. . ."; "MR. CARTY told me that they were simply forms . . . needed . . . for the continuing management of our family funds . . ."; "MR. CARTY repeatedly told us that any document papers were . . . so that he could 'manage our money'." (App., 6a-7a.)

These are all comments that, on their face, refer to the making of the contract generally, not the arbitration clause specifically. As such, they should have been compelled to arbitration under the *Prima Paint* doctrine.

1. Contrary to the Position of the California Courts, the Circuit Courts of Appeals Reject Challenges to Arbitration Based Upon the Allegations of a Failure to Read the Contract.

Underlying the respondents' claims of fraud in the inducement of the contract is the admitted fact that they did not read the 12 contracts containing arbitration clauses before they signed them. Of this admitted failure to read the contracts, the California Court of Appeal, in *Lynch v. Cruttenden & Co.*, 18 Cal. App. 4th 802, 22 Cal. Rptr 2d 636 (1993) (App., 8a-9a), wrote:

> The general rule in California is that even in the absence of a fiduciary relationship plaintiff's failure to read a contract is excusable where reliance is placed on the misrepresentations of the other party.

Id. at 807, 22 Cal. Rptr. 2d at 639 (App., 8a-9a). The *Lynch* court relied upon prior California state court decisions to assert that this general rule is particularly applicable in cases where the plaintiff is unfamiliar with stockbrokerage documents and "is deceived as to the nature and effect of the documents." *Id.*

Many well-reasoned cases of the United States Courts of Appeals, however, have reviewed the circumstances under which a party may be excused from reading a contract and have reached precisely the opposite result.[4] The Ninth Circuit, in *Cohen v.*

---

[4]Indeed, California state courts themselves seem to belie the *Lynch* court's interpretation of the general rule in California. *See Rowland v. PaineWebber Inc.*, 4 Cal. App. 4th 279, 286, 6 Cal. Rptr. 2d 20, 24 (1992) ("[r]easonable diligence requires the reading of a contract before signing it. A party cannot use his own lack of diligence to avoid an arbitration agreement"); *Macaulay v. Norlander*, 12 Cal. App. 4th 1, 6, 15 Cal. Rptr. 2d 204, 207 (1992) ("[r]espondents . . . were bound by the provisions of the client agreement whether they read it or were aware of the arbitration clause when they signed the document"); *Parr v. Superior Court*, 139 Cal. App. 3d 440, 445-46, 188 Cal. Rptr. 801, 804 (1983) ("[a]t the same time, that very person, whether in fact he had read it or not, could choose alternatively to seek arbitration, or, should he prefer, to perform and receive the benefits of the contract . . ."); *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 20 Cal. App. 3d

Wedbush, Noble, Cooke, Inc., 841 F.2d 282 (9th Cir. 1988), recognized that, despite allegations of misrepresentations:

> We see no unfairness in expecting parties to read contracts before they sign them..... We therefore hold that allegations of misrepresentations directly contrary to the specific and unambiguous terms of a written arbitration agreement do not, *as a matter of law*, state a claim for fraud..... *Whether the Cohens read the agreement but did not notice the arbitration clause, or chose not to read the agreement at all, their reliance on Wedbush's alleged misrepresentations was unreasonable* in light of the clear and explicit language of the contract.

Id. at 287-88 (emphasis added).

In *Perez & Assoc. v. Welch*, 960 F.2d 534, 538 (5th Cir. 1992), the court noted that two customers of a securities broker signed customer agreements containing arbitration clauses without first reading the documents. This did not allow these customers to bypass contractual arbitration.

Likewise, in *Pierson v. Dean Witter Reynolds Inc.*, 742 F.2d 334, 339 (7th Cir. 1984), the court ruled that the failure to read a brokerage contract cannot be used to avoid the consequences of an arbitration clause contained in that contract.

Federal courts interpreting the FAA, therefore, have reached a conclusion directly contrary to that reached by the California courts in the present case.

668, 672, 97 Cal. Rptr. 811, 813 (1971) (court enforced arbitration agreement despite assumption for argument's sake that it was "adhesory").

2. Contrary to the Position of the California Courts, the United States Courts of Appeals Reject Challenges to Arbitration Based Upon the Allegation that the Broker Advised that the Contract Was a Mere Formality that Would Not Affect Legal Rights and Did Not Advise of the Existence of the Arbitration Clause.

Of the respondents' allegations that they were advised that the account documents were a "mere formality" and that they were not told that the documents contained arbitration clauses, the *Lynch* court wrote:

> [W]e fail to see why a representation that signing a document will not affect the Lynches [sic] rights, cannot fairly be characterized as fraud going directly as to the arbitration clause, a clause that clearly affects the Lynches' rights.
>
> * * *
>
> The alleged representation, that the documents were a formality and did not affect the rights of the Lynches, was tantamount to a representation that the documents contained no arbitration clause.

18 Cal. App. 4th at 809-10, 22 Cal. Rptr. at 640-41 (App., 10a-11a).[5]

The Ninth Circuit in *Cohen*, however, squarely rejected an assertion similar to that relied upon by the *Lynch* court that a representation that the agreement does not affect legal rights is "tantamount" to fraud aimed directly at the arbitration clause. *Cohen*, 841 F.2d at 287. On the same issue, the Ninth Circuit held in *Cohen*:

> The Cohens' other allegation in support of the claim of fraud is that they were "advised, either expressly or implicitly . . . that [the margin agreement] did not compromise any of

---

[5]The *Lynch* court also attempted to distinguish the *Cohen* decision upon the grounds that there was no fiduciary relationship alleged in *Cohen* as there was in *Lynch*. The effect of the fiduciary duty allegations upon the rule in *Prima Paint* is discussed in detail in Section D *infra*.

> [their] rights." ... [T]he alleged statement here cannot fairly be characterized as fraud in the inducement as to the *arbitration* clause. The statement is quite general, relating to the contract as a whole rather than to the arbitration clause in particular. Indeed, the Cohens complain that nothing at all was said about the abritration clause. Because the Cohens have not raised a challenge to the validity of the arbitration clause itself, this issue is subject to mandatory arbitration.

Id. at 287.

The federal court interpreting the FAA, therefore, reached a conclusion directly contrary to that reached by the California courts in the present case.

3. Contrary to the Position of the California Courts, the United States Courts of Appeals Have Rejected the Notion that Allegations of Fraud in the Inducement Can be Directed at Both the Arbitration Clause and the Contract As A Whole.

The *Lynch* court characterized allegations of fraud in the inducement of a contract generally as follows:

> That the misrepresentation may go to some or even all of the clauses of the contract as well as the arbitration clause does not mean that fraud in the making of agreement for arbitration is not in issue. *Prima Paint* does not stand for the proposition that a fraudulently induced arbitration agreement becomes valid and enforceable if the fraud also goes to other parts of the contract.

18 Cal. App. 4th at 810, 22 Cal. Rptr. 2d at 641.

Federal courts, however, hold that *Prima Paint* stands precisely for the proposition that fraud which goes to portions of the contract in addition to the arbitration clause must be compelled to arbitration.

In *Arnold v. Arnold*, 920 F.2d 1269 (6th Cir. 1990), the court provided the following interpretation of the *Prima Paint* doctrine:

> The question presented by the present case is thus whether the amended complaint contains a well-founded claim of

> fraud in the inducement of the arbitration clause itself, *standing apart from the whole agreement*, that would provide grounds for the revocation of the agreement to arbitrate.

Id. at 1278. *See also Sweet Dreams Unlimited v. Dial-A-Mattress Int'l*, 1F.3d 639, 641 n.4 (7th Cir. 1993) ("[a] court may consider a claim that a contracting party was fraudulently induced to include an arbitration provision in the agreement but not claims that the entire contract was the product of fraud").

Likewise, the Ninth Circuit has rejected reasoning similar to that of the *Lynch* court that allegations of fraud in the inducement may be directed both at the contract generally and at the arbitration clause and still bypass arbitration. *Kone*, 892 F.2d at 1410; *Three Valleys*, 925 F.2d at 1140.

The California courts, therefore, refused to compel arbitration of the present allegations in contravention of the controlling federal precedent.

D. ALLEGATIONS OF A FIDUCIARY RELATIONSHIP DO NOT JUSTIFY THE COURT'S DEPARTURE FROM *PRIMA PAINT* DOCTRINE IN THE ABSENCE OF EXTRAORDINARY ABUSES OF THE RELATIONSHIP.

The California Court of Appeal attempted to distinguish the facts before it from those in applicable federal cases by asserting that the respondents' allegation of a preexisting fiduciary duty with the broker justified their failure to read their contracts before signing them. The only factual allegation the respondents offered, however, to support the alleged existence of a fiduciary duty was that the broker secured the trust and confidence of the respondents before asking them to sign the customer agreements. (App., 6a-7a.) The same type of allegation did not preclude arbitration under the FAA in *Perez & Assoc. v. Welch*, 960 F.2d 534, 538 (5th Cir. 1992). In that case, two custmers of securities broker-dealers complained that they signed customer agreements without reading them or understanding that they contained arbitration clauses because they "trusted" the broker. Because that trust led them to execute the entire contract, however, and not just the

arbitration clause, the issue of breach of fiduciary duty itself was referred to arbitration.

In *Bhatia v. Johnston*, 818 F.2d 418 (5th Cir. 1987), the fact that the broker and the customer had a preexisting relationship at another brokerage firm did not excuse arbitration even though the customer alleged that the broker misrepresented the terms of the new customer agreement to him.

Likewise, the Supreme Court of Alabama considered whether allegations by a brokerage customer of fraud in the inducement of the contract containing an arbitration clause mandate a hearing by the court when they are combined with the allegation that the broker owed a fiduciary duty to disclose the existence of the arbitration clause. That court refused to allow such allegations to defeat contractual arbitration under the FAA:

> The plaintiff contends that the "central issue in this case is whether Merrill Lynch owed a duty to [her] to disclose the . . . material facts regarding the arbitration agreement." . . . The omission to do so, the argument goes, constituted fraud in the making of the arbitration clause itself. We also reject that argument because Mrs. Jones' claim of breach of fiduciary duty to disclose material facts applies as cogently to all of their claims as to the arbitration clause itself.

Jones v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 604 So.2d 332, 338 (Sup. Ct. Ala. 1991). *See also Capital Income Properties-LXXX v. The Honorable R. Blackmon*, 843 S.W.2d 22, 23 (Sup. Ct. Tex. 1992) ("[a] claim of fraud in the inducement, unless specifically directed to the making of the arbitration clause, does not defeat application of that clause to the agreement as a whole").

The California courts, therefore, refused to compel arbitration for reasons directly contradicted by holdings of the federal courts and other state courts of last resort.

E. THERE IS NO DISPUTE THAT FEDERAL LAW CONTROLS THE ISSUES DECIDED IN THE CASE BELOW AND PREEMPTS CONFLICTING STATE LAW.

There is no dispute that the present controversy is governed by the FAA *See Rowland v. PaineWebber Inc.*, 4 Cal. App. 4th 279, 6 Cal. Rptr. 2d 20 (1992); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987), which provides that a contract involving interstate commerce and containing an arbitration clause shall be enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. §§ 1 & 2 (1982); *Republic of Nicaragua v. Standard Fruit Co.*, 937 F.2d 469, 475 (9th Cir.), *cert. denied*, 117 L. Ed. 2d 516 (1991). As the transactions in the respondents' accounts involved national securities exchanges, they were performed under contracts evidencing transactions involving commerce. *Cohen*, 841 F.2d at 284; *Macchiavelli v. Shearson, Hammill & Co.*, 384 F. Supp. 21, 30 (E.D. Cal. 1974).

Both state and federal courts recognize that on issues of arbitration stemming from contracts governed by the FAA, federal law preempts conflicting state law. *Southland Corp. v. Keating*, 465 U.S. 1, 13, 104 S. Ct. 852, 79 L. Ed. 2d 1, 13 (1984); *Bayma v. Smith Barney, Harris Upham & Co.*, 784 F.2d 1023, 1025 (9th Cir. 1986); *Tonetti v. Shirley*, 173 Cal. App. 3d 1144, 1148-50, 219 Cal. Rptr. 616, 618-20 (1985). As this Court itself has decreed, the pronouncement of a federal court on the FAA supersedes any contrary state law *Volt Info. Sys. Inc. v. Board of Trustees of the Leland Standford Junior Univ.*, 489 U.S. 468, 477, 103 L. Ed. 2d 488, 499 (1989) ("state law may nonetheless be preempted *to the extent that it actually conflicts with federal law*' ") (emphasis added).

The federal preemption doctrine has been applied to the exclusion of contrary state interpretations of Section 2 of the FAA, which was relied upon by the California courts below:

> Section 2 [of the FAA] is a Congressional declaration of a liberal federal policy favoring arbitration agreements, *notwithstanding any state substantive or procedural policies to*

> *the contrary*. The effect of this section is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act.... [T]he Courts of Appeals have ... consistently concluded that questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration. We agree. The Arbitration Act establishes that as a matter of federal law, any doubts concerning the scope of arbitral issues should be resolved in favor of arbitration, *whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability*.

Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25, 103 S. Ct. 927, 941, 74 L. Ed. 2d 765, 785 (1983) (emphasis added).

Thus, it is clear that where the federal courts have spoken on issues under the FAA, that law controls both in state and federal courts. *(See, e.g., Southland Corp. v. Keating*, 465 U.S. 1, 104 S. Ct. 852, 79 L. Ed. 2d 1 (1984) (California Supreme Court overruled); *Perry v. Thomas*, 482 U.S. 483, 489, 107 S. Ct. 2520, 96 L. Ed. 2d 426 (1987) (California statute preempted). Because the federal courts have explicitly and uniformly ruled that allegations such as those raised below must be compelled to arbitration, the California courts were bound to follow that federal precedent.

II.

REVIEW SHOULD BE GRANTED BECAUSE THE DECISION BELOW DEPARTS FROM AND SUBSTANTIALLY UNDERMINES THIS COURT'S STRONG ENDORSEMENT OF SECURITIES ARBITRATION.

This petition should be granted for an additional and equally important reason — the opinion below and the prior California state court opinions upon which it relies create a loophole in the alternative dispute resolution process relied upon by the brokerage industry and strongly endorsed by this Court. Unless this Court grants review, the California courts are likely to continue to undermine this Court's policy favoring arbitration and to broaden

California's articulation of policies directly conflicting with federal courts' interpretation of federal law.

Despite this Court's clear articulation of a policy favoring arbitration, the California courts have issued opinions interpreting the FAA in a manner which permits individuals to defeat arbitration by generalized allegations of fiduciary nondisclosure combined with admitted failures to read contracts. The decision below goes farther than any prior California decision in undermining federal policy. Read broadly, it suggests that a client of a brokerage firm can fail to read a contract, can ignore bold-faced, highlighted clauses in the contract, can ask no questions of his broker, and can nonetheless avoid a clear contractual provision providing for arbitration merely by claiming that he relied upon the broker as a "fiduciary" and was told the contract was a "formality."

Federal policy is directly to the contrary, requiring that all doubts be resolved in favor of ordering — not denying — arbitration. Indeed, this Court itself has strongly endorsed arbitration of disputes between brokerage firms and its customers, sweeping away prior decisions founded largely upon a mistrust of arbitration as a proper forum for the enforcement of customers' rights. *See, e.g., Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 105 S. Ct. 1238, 84 L. Ed. 2d 158 (1985); *McMahon*; and *Rodriguez de Quijas v. Shearson/American Express Inc.*, 490 U.S. 477, 109 S. Ct. 1917, 104 L. Ed. 2d 526 (1989).

This Court's statement of policy in favor of arbitration relies, in part, upon the inherent fairness of arbitration and the oversight of the industry arbitration rules and procedures by the Securities and Exchange Commission. *See, e.g., McMahon*, 482 U.S. at 233-34.

The decision below is inconsistent with the federal policies articulated in these cases. It creates a convenient road map for a plaintiff intent on avoiding arbitration and essentially says that an arbitrator is incapable of deciding threshold issues of fiduciary fraud or misrepresentation. It turns the advantage of arbitration on its head by burdening the courts with deciding threshold factual issues concerning the entry into agreements. A better and more efficient policy is to let arbitrators decide whether genera-

lized fraud claims are sufficient to release a claimant from an arbitration obligation or whether a claimant's acceptance of contractual benefits from a brokerage firm for months or years at a time constitutes acceptance of all terms of the governing contract.

CONCLUSION

For these reasons, petitioners request that this Court accept this matter for review.

Dated: March 14, 1994

Respectfully submitted,

DAWN M. SCHOCK
Counsel of Record
JOHN R. LOFTUS
KEESAL, YOUNG & LOGAN
Attorneys for Petitioners
CRUTTENDEN & COMPANY, TALLEY
MCNEIL & COMPANY, INC., AND
ROBERT C. CARTY, JR.

GILBERT R. SEROTA
HOWARD, RICE, NEMEROVSKI,
CANADY, ROBERTSON, FALK & RABKIN
Attorneys for Petitioner
Sutro & Co., Inc.

SUPERIOR COURT OF CALIFORNIA
COUNTY OF VENTURA
LAW & MOTION MINUTE ORDER
HON. EDWIN M. OSBORNE

Reporter: R. JEFFREY
Clerk: BARBARA GALLISON
Bailiff: DOUGLAS BENTLEY
For: 2/19/92 Wednesday Dept: 43

5. 3:30 PM Case No: 119524

ROBERT A. LYNCH

VS.

CRUTTENDEN & COMPANY

Addl Info:
Filing Date: 12/27/91
Case: FRAUD
At Issue: 00/00/00
Trial:
Event: [D] MOTION TO COMPEL ARBITRATION & STAY PROCEEDINGS (CRUTTENDEN & CO., TALLEY McNEIL & CO. INC. & ROBERT CARTY JR.)

Plntff: LYNCH, ROBERT A. TRSTEE: LYNCH FAMILY TRUST DATED 05-30-79	ATTY: P. GOLDENRING & GOLDENRING
Plntff: LYNCH, BETTY LAVERNE TRSTEE: LYNCH FAMILY TRUST DATED 05-30-79	ATTY: P. GOLDENRING & GOLDENRING
Defndt: CRUTTENDEN & COMPANY	Atty: KEESAL YOUNG & LOGAN
Defndt: TALLEY MCNEIL & COMPANY INC.	Atty: KEESAL YOUNG & LOGAN
Defndt: SUTRO & CO. INC.	
Defndt: CARTY JR., ROBERT C.	Atty: KEESAL YOUNG & LOGAN
Defndt: SUN LIFE ASSURANCE COMPANY OF CAN	DAWN M. SCHOK
Defndt: LOOMIS SAYLES & CO.	

☐ Courts Motion ☐ Moving Party Request ☐ Stipulation
☐ OFF CALENDAR ☐ No Appearance ☐ No Proof of Service
☐ CONTINUED TO: __/__/__ at_____ p.m. in courtroom _____,
Judge _____
_____LMI

☑ MOTION(S) are submitted ☑ with ☐ without argument.

☑ MOTION(S): ☐ GRANTED ☑ DENIED IN ITS ENTIRETY
☐ WITHOUT PREJUDG ☐ SUBMITTED

☐ PURSUANT TO THE FORMAL ORDER NOW SIGNED BY THE COURT

☐ DEMURRER: ☐ OVERRULED ☐ SUSTAINED on grounds

_____

_____

_____

☐ Pltf ☐ Deft ☐ _____ is granted ____ days leave within which to ☐ amend ☐ answer.

☐ _____

_____

_____

_____

_____

☐ Notice waived. ☑ Counsel for ☑ Pltf ☐ Deft ☐ _____ is directed to ☑ give notice. ☐ prepare and serve a formal order.

SHEILA GONZALEZ, Superior Court
Executive Officer and Clerk

By: Barbara Gallison
Deputy Clerk

SUPERIOR COURT OF CALIFORNIA
COUNTY OF VENTURA
LAW & MOTION MINUTE ORDER
HON. STEVEN Z. PERREN

Reporter: Sharon Lewis
Clerk: Julie Camacho
Bailiff: M. Hanks
For: 3/12/92 Thursday Dept. 30
4. 3:30 P.M. Case No. 119524

ROBERT A. LYNCH

VS.

CRUTTENDEN & COMPANY

Addl Info: Filing Date: 12/27/91
Case: FRAUD At Issue: 00/00/00
Trial:
Event: [D] MOTION TO COMPEL ARBITRATION AND MTN TO STAY FURTHER PROCEEDINGS IN THIS ACTION (SUTRO & CO. INC.)

Plntff: LYNCH, ROBERT A. TRSTEE: LYNCH FAMILY TRUST DATED 05-30-79	ATTY: PETER GOLDENRING & GOLDENRING
Plntff: LYNCH, BETTY LAVERNE TRSTEE: LYNCH FAMILY TRUST DATED 05-30-79	ATTY: GOLDENRING & GOLDENRING
Defndt: CRUTTENDEN & COMPANY	Atty: KEESAL YOUNG & LOGAN
Defndt: TALLEY MCNEIL & COMPANY INC.	Atty: KEESAL YOUNG & LOGAN
Defndt: SUTRO & CO. INC.	Atty: GILBERT R. SEROTA
Defndt: CARTY JR., ROBERT C.	Atty: KEESAL YOUNG & LOGAN
Defndt: SUN LIFE ASSURANCE COMPANY OF CAN	
Defendt: LOOMIS SAYLES & CO.	

☐ Courts Motion ☐ Moving Party Request ☐ Stipulation
☐ OFF CALENDAR ☐ No Appearance ☐ No Proof of Service
☐ CONTINUED TO: __/__/__ at____ p.m. in courtroom _____,
Judge _____
_____LMI

☑ MOTION(S) are submitted ☑ with ☐ without argument.
☑ MOTION(S): ☐ GRANTED ☑ DENIED
☐ WITHOUT PREJUDG ☐ SUBMITTED

☐ PURSUANT TO THE FORMAL ORDER NOW SIGNED BY THE COURT

☐ DEMURRER: ☐ OVERRULED ☐ SUSTAINED on grounds

_____

_____

_____

☐ Pltf ☐ Deft ☐ _____ is granted ____ days leave within which to ☐ amend ☐ answer.

☐ _____

_____

_____

_____

_____

☐ Notice waived. ☑ Counsel for ☑ Pltf ☐ Deft ☐ _____ is directed to ☑ give notice. ☐ prepare and serve a formal order.

SHEILA GONZALEZ, Superior Court
Executive Officer and Clerk

BY: JULIE CAMACHO
Deputy Clerk

COURT OF APPEAL OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION SIX
2ND CASE of Level 1 printed in FULL format.

ROBERT A. LYNCH et al.,
Plaintiffs and Respondents,
v.
CRUTTENDEN & COMPANY et al.,
Defendants and Appellants.
Nos. B065198, B066610
18 Cal. App. 4th 802; 1993 Cal. App.
LEXIS 912; 22 Cal. Rptr. 2d 636; 93 Cal. Daily Op.
Service 6712; 93 Daily Journal DAR 11395

September 2, 1993, Filed

NOTICE: [*1] THE LEXIS PAGINATION OF THIS DOCUMENT IS SUBJECT TO CHANGE PENDING RELEASE OF THE FINAL PUBLISHED VERSION.

SUBSEQUENT HISTORY: Review Denied December 16, 1993, Reported at: *1993 Cal. LEXIS 6481.*

PRIOR HISTORY: Superior Court County of Ventura. Super. Ct. No. 119524. Hons. Edwin M. Osborne and Steven Z. Perren, Judges.

COUNSEL: Howard, Rice, Nemerovski, Canady, Robertson & Falk, and Gilbert R. Serota and John M. Chaisson for Defendants and Appellants Sutro & Co., Inc.

Keesal, Young & Logan, Dawn M. Schock and John R. Loftus for Defendants and Appellants Cruttenden & Company and Talley McNeil & Company, Inc. and Robert C. Carty, Jr.

Goldenring and Goldenring and Peter A. Goldenring for Plaintiffs and Respondents.

JUDGES: GILBERT, Acting P.J.; YEGAN, J., and WILLARD, J., *concurring.

---

* Retired judge of the superior court sitting under assignment by the Chairperson of the Judicial Council.

OPINION BY: GILBERT

OPINION:
GILBERT, Acting P.J.:

This consolidated appeal concerns the denial of two motions to compel arbitration made in the same case. We hold that the plaintiffs' allegations of fraud are sufficient to support the denial of the motions, and that the denial does not conflict with *Prima Paint Corp. v. Flood & Conklin (1967) 388 U.S. 395, 18 L. Ed. 2d 1270, 87 S. Ct. 1801.*

FACTS

Robert and Betty Lynch filed an action [*2] against Cruttenden & Company, Talley McNeil & Company, Robert C. Carty (hereinafter collectively "Cruttenden") and Sutro & Co. The complaint alleged that Carty, a licensed securities broker, acted as the agent of and in conspiracy with Cruttenden and Sutro, licensed brokerage houses, to defraud the Lynches by taking excessive fees.

The complaint states that the Lynches became personal friends of Carty in 1989. Carty encouraged them to have trust and confidence in him and to rely on him for financial advice. The Lynches opened accounts with Cruttenden and Sutro through Carty and transferred money to the defendants. Carty instructed the Lynches to sign various documents from time to time. He told the Lynches the documents were "... necessary to effect the continuing reliance and trust by [the Lynches in Carty and the other defendants], and that the documents did not affect legal rights and it was not necessary that they be read." The Lynches also alleged Carty told them the documents were necessary to open accounts and were only a formality. The Lynches claimed they were not advised of the contents of the documents and were not provided "... any substantial opportunity to read" [*3] them.

Cruttenden and Sutro responded by making separate motions to compel arbitration. Attached to the moving papers were various documents purportedly signed by the Lynches. The documents contained arbitration clauses in bold type requiring the

parties to submit disputes to arbitration before the National Association of Securities Dealers, Inc. or the New York Stock Exchange.

The Lynches filed affidavits in opposition to the motions. Robert Lynch declared that he attended school only to the ninth grade. Prior to meeting Carty he never had a securities account and never executed stockbroker or brokerage house agreements. Lynch first met Carty in 1988. Carty manipulated Lynch into believing Carty was a very close friend and confidante. At the beginning Carty did not mention managing Lynch's money, but spent considerable time befriending him, visiting him at his home or office as often as twice a week. In the course of the developing friendship Lynch told Carty that he owned a cement business he built from scratch. Lynch said that he was considering selling the business and investing the proceeds for retirement and for his children.

Eventually the Lynches sold the business for $5,000,000. [*4] They wanted to invest what remained after taxes and Carty asked the Lynches to allow him to manage the funds. Lynch said he had no experience with stocks. Carty told Lynch repeatedly that he should trust him and rely on his expertise and management skills.

Carty told Lynch that documents he was asked to sign were " 'standard' " and a " 'formality.' " Carty specifically discouraged Lynch from reading the documents, repeatedly referring to their friendship and the level of trust that had developed. At no time was Lynch told that the documents were contracts or that they contained an arbitration clause or otherwise limited their rights.

Lynch declared that as result of churning and mismanagement by Carty and the other defendants, the Lynches' funds have been reduced by well over half while defendants earned approximately $1,000,000 in commissions. An affidavit submitted by Betty Lynch affirmed her husband's declarations.

The trial court separately denied each motion and the moving parties appealed.

DISCUSSION

Our task on appeal is simply to determine whether the plaintiffs have alleged in their complaint and affidavits sufficient facts to warrant a trial on the validity of the arbitration [*5] agreement. (See *Strotz v. Dean Witter Reynolds, Inc. (1990) 223 Cal. App. 3d 208, 211272 Cal. Rptr. 680, fn. 2.)*

The Federal Arbitration Act provides that a written arbitration provision in a contract involving commerce is valid and enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract." *(9 U.S.C. § 2.)* Of course, it is well recognized that fraud may be a ground for the revocation of a contract. (See 1 Witkin, Summary of Cal. Law (9th ed. 1987) Contracts, § 392, p. 356; Rest.2d Contracts, § 7 com. b, at p. 22.)

Cruttenden and Sutro contend, however, that none of the statements alleged to have been made by Carty were false. Carty was alleged to have represented that the documents were standard, a formality and did not affect the rights of the Lynches. It may be true that the documents were standard, but it is untrue that the documents were a formality and that they did not affect the Lynches' rights.

If the agreements are enforceable, the Lynches have waived their right to a jury trial, limited their discovery rights, and waived their right to appeal. It is anomalous for Cruttenden and Sutro to argue [*6] on appeal they are trying to enforce an agreement against the Lynches, and to also argue the agreement is a formality and does not affect the Lynches' rights.

Cruttenden and Sutro claim the Lynches cannot rely on their own failure to read the agreements. However, California cases have consistently taken the position that where a plaintiff is unfamiliar with the nature of the documents used in the stock-brokerage business and is deceived as to the nature and effect of the documents, failure to read the documents is excusable. (See *Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc. (1977) 67 Cal. App. 3d 19, 30-33, 136 Cal. Rptr. 378; Strotz v. Dean Witter Reynolds, Inc., supra, 223 Cal. App. 3d 208, 218-219; Rice v. Dean Witter Reynolds, Inc. (1991) 235 Cal. App. 3d 1016, 1025-1026.)* The general rule in California is that even in the absence

of a fiduciary relationship plaintiff's failure to read a contract is excusable where reliance is placed on the misrepresentations of the other party. (1 Witkin, Summary of Cal. Law (9th ed. 1987) Contracts, § 407, p. 366.) The Restatement of Contracts Second adopts a similar position. (See [*7] Rest.2d Contracts, § 177.)

Our recent decision in *Rowland v. Paine Webber Inc. (1992) 4 Cal.App.4th 279* is not to the contrary. There Rowland was a former securities broker and employee of Paine Webber, and "presumably, he was familiar with all industry contract terms necessary to open an investment account." *(Id. at p. 286.)* Here the representation that the documents did not affect the Lynches' rights is equivalent to a representation that the documents are not contracts, a deception as to the nature and effect of the documents.

Cruttenden and Sutro stated at oral argument that the Lynches never alleged they did not know they were signing contracts. But the Lynches alleged they were ignorant of the falsity of Carty's representations and believed them to be true. The Lynches could not have believed Carty's representation that the documents would not affect their legal rights, and also have known they were signing contracts.

As to Carty's status as a non-lawyer, a person may be found to have reasonably relied on the legal opinion of a non-lawyer where the recipient of the opinion is in a relationship of trust and confidence, or where [*8] the recipient of the opinion reasonably believes that, as compared with himself, the maker of the opinion has special knowledge or skill with respect to the subject matter. (Rest.2d, Contracts, §§ 169, 170; and com. b to § 170 [reliance may be reasonable where, for example, a real estate broker or insurance agent gives an opinion of law on a routine matter within his competence to a layman]; 5 Witkin, Summary of Cal. Law (9th ed. 1988) Torts, §§ 680, 682, 684, pp. 781-782, 784, 785.) The Lynches' allegations are sufficient to bring them within either of these circumstances.

Cruttenden and Sutro's reliance on *Cohen v. Wedbush, Noble, Cooke, Inc. (9th Cir. 1988) 841 F.2d 282* is misplaced. There the Cohens signed a margin account agreement containing an arbitra-

tion clause. In response to Wedbush's motion to compel arbitration the Cohens alleged that Wedbush did not explain the meaning and effect of the arbitration clause. The court held: "We know of no case holding that parties dealing at arm's length have a duty to explain to each other the terms of a written contract. We decline to impose such an obligation. . . ." *(Id. at p. 287.)* [*9]

In response to the Cohens' allegation that they were advised " '. . . either expressly or implicitly . . .' " that the agreement did not compromise any of their rights, the court replied, "Even assuming the dubious proposition that an 'implicit' statement by a non-lawyer regarding a question of law can constitute fraud, the alleged statement here cannot fairly be characterized as fraud in the inducement as to the arbitration clause." *(Cohen v. Wedbush, Noble, Cooke, Inc., supra, 841 F.2d 282, 287.)*

The court also said that even assuming the alleged statements were specifically directed to the arbitration clause there was no fraud because reliance on a misrepresentation is not reasonable when plaintiff could have ascertained the truth by reading the contract. *(Cohen v. Wedbush, Noble, Cooke, Inc., supra, 841 F.2d 282, 287.)*

In Cohen the court assumed the parties were dealing at arm's length. The case did not discuss whether Wedbush was acting in a fiduciary capacity. Where a person reposes trust and confidence in another and the person in whom such confidence is reposed obtains control over the other person's affairs, a fiduciary relationship [*10] is created. *(Ford v. Shearson Lehman American Express, Inc. (1986) 180 Cal. App. 3d 1011, 1020, 225 Cal. Rptr. 895.)* Here the Lynches allege that Carty obtained control over their funds through the trust and confidence they reposed in him as a friend and a purported expert in investments. The Lynches also alleged that Carty was acting as the agent of Cruttenden and Sutro. This is sufficient to allege that the defendants were acting in a fiduciary capacity.

Second, as we will discuss below, we fail to see why a representation that signing a document will not affect the Lynches rights, cannot fairly be characterized as fraud going directly as to the arbitration clause, a clause that clearly affects the Lynches' rights.

Third, in stating there could be no fraud if the plaintiffs did not read the contract, the Cohen court ignored California authority and the Restatement, which are to the contrary.

II

Cruttenden and Sutro next contend that even if the elements of fraud are sufficiently alleged, arbitration is required under *Prima Paint Corp. v. Flood & Conklin, supra, 388 U.S. 395.*

Prima Paint contracted to buy F & C's business. The parties also contracted [*11] that F & C would serve as a consultant to Prima Paint for six years. The consulting agreement contained an arbitration clause. No reference was made in the agreements to possible financial problems which F & C might encounter. Shortly after the first payment was due under the consulting agreement, Prima Paint notified F & C's attorney that their client had fraudulently represented it was solvent and able to perform its contractual obligations, whereas it was insolvent and intended to file a petition in bankruptcy. Prima Paint filed suit for recision on the ground of fraud in the inducement. F & C sought to stay the court proceeding pending arbitration.

In upholding the order staying proceedings pending arbitration, the court pointed out that there was a conflict in the federal courts of appeals over whether ". . . arbitration clauses as a matter of federal law are 'separable' from the contracts in which they are imbedded. . . ." *(Prima Paint Corp. v. Flood & Conklin, supra, 388 U.S. 395, 402.)* If separable, the arbitration clause is broad enough to encompass claims of fraud ". . . where no claim is made that fraud was directed to the arbitration clause [*12] itself. . . ." (Ibid.)

The Supreme Court held the answer was to be found in section 4 of the Federal Arbitration Act. "Under § 4, . . . the federal court is instructed to order arbitration to proceed once it is satisfied that 'the making of the agreement for arbitration or the failure to comply [with the arbitration agreement] is not in issue.' Accordingly, if the claim is fraud in the inducement of the arbitration clause itself — an issue which goes to the 'making' of the agreement to arbitrate — the federal court may proceed to adjudicate

it. But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally." *(Prima Paint Corp. v. Flood & Conklin, supra, 388 U.S. 403-404,* fns. omitted.)

Cruttenden and Sutro argue that here the claim of fraud goes to the inducement of the contract generally, and does not go to the making of the agreement for arbitration. We disagree. The alleged representation that the documents were a formality and did not affect the rights of the Lynches, was tantamount to a representation that documents contained no arbitration clause. Because the representation is in direct [*13] conflict with the existence of an arbitration clause, the making of the agreement for arbitration is in issue and the court has no power to order arbitration under section 4 of the Act.

That the misrepresentation may go to some or even all of the clauses of the contract as well as the arbitration clause does not mean that fraud in the making of agreement for arbitration is not in issue. Prima Paint does not stand for the proposition that a fraudulently induced arbitration agreement becomes valid and enforceable if the fraud also goes to other parts of the contract. Prima Paint simply interpreted section 4 of the Act as requiring the arbitration provision of the contract to be treated as a separate agreement for the purpose of determining whether it is enforceable.

The fraud alleged in Prima Paint concerned misrepresentation of a party's financial condition. In contrast to the instant case there was no allegation in Prima Paint that a party was misled as to the existence or effect of the arbitration clause. Here, it is alleged the parties were misled as to the very existence of the arbitration clause. In Prima Paint the fraud went to the making of the contract generally, not to the [*14] making of the arbitration clause.

California cases are unanimous in holding that Prima Paint does not require arbitration where, as alleged here, the plaintiffs were so deceived they did not understand they were contracting. *(Ford v. Shearson Lehman American Express, Inc., supra, 180 Cal.App.3d 1015, 1028-1029; Strotz v. Dean Witter Reynolds,*

Inc., supra, 223 Cal.App.3d 208, 217; Rice v. Dean Witter Reynolds, Inc., supra, 235 Cal.App.3d 1016, 1023; compare, *Rowland v. Paine Webber Inc., supra, 4 Cal. App. 4th 279,* where plaintiff, a retired stockholder, could not have been so deceived.) Such a fraud necessarily raises issues that go directly to the making of the agreement to arbitrate. Thus under section 4 of the Act the court may not order arbitration unless those issues are resolved in court against the plaintiffs.

Cruttenden and Sutro seek to distinguish Ford, Strotz and Rice on the ground that in those cases the defendants exerted complete dominion and control over the plaintiff's affairs. But we know of no requirement that plaintiffs allege complete dominion or control in [*15] order to sustain an allegation of fraud. We agree with the trial court judges. The allegations in the instant case are sufficient.

The orders denying the defendants' motions for arbitration are affirmed. Costs on appeal are awarded to the Lynches.

YEGAN, J., and WILLARD, J., concurring.

IN THE SUPREME COURT
OF THE
STATE OF CALIFORNIA

Second Appellate District
Division Six
No. B065198/B066610
S035471

IN BANK

ROBERT A. LYNCH Et Al.,
Respondents

v.

CRUTTENDEN & COMPANY Et Al.,
Appellants.

Appellants' petition for review DENIED.

LUCAS
Chief Justice

DAWN M. SCHOCK (121746)
JOHN R. LOFTUS (126841)
KEESAL, YOUNG & LOGAN
A Professional Corporation
Catalina Landing — 310 Golden Shore
Post Office Box 1730
Long Beach, California 90801-1730
Telephone: (310) 436-9051
Attorneys for Defendants
Cruttenden & Company, Talley McNeil & Company, Inc., and Robert C. Carty, Jr.

SUPERIOR COURT OF CALIFORNIA
COUNTY OF VENTURA

ROBERT A. LYNCH, BETTY LAVERNE LYNCH, individually and as TRUSTEES OF THE ROBERT A. LYNCH AND BETTY LAVERNE LYNCH FAMILY TRUST DATED MAY 30, 1979,
Plaintiffs,

vs.

CRUTTENDEN & COMPANY, TALLEY MCNEIL & COMPANY, INC., SUTRO & CO., INC., ROBERT C. CARTY, JR., SUN LIFE ASSURANCE COMPANY OF CANADA, SUN FINANCIAL GROUP, LOOMIS SAYLES & CO., DOES 1 through 100, inclusive,
Defendants.

No. 119524

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF MOTION TO COMPEL ARBITRATION AND STAY PROCEEDINGS; DECLARATIONS OF ROBERT C. CARTY, JR., MARILYN FRANCE, AND JOHN R. LOFTUS

Date: February 19, 1992
Time: 3:30 p.m.
Dept: 43

TABLE OF AUTHORITIES

Federal Cases

Page

Bayma v. Smith Barney, Harris Upham & Co., 784 F.2d 1023 (9th Cir. 1986) 19a, 47a, 60a

Cauble v. Mabon Nubert & Co., 594 F. Supp. 985 (1984) ..

Cohen v. Wedbush, Noble, Cooke, Inc., 841 F.2d 282 (9th Cir. 1988) 9a, 10a, 18a, 19a, 47a

Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213, 84 L.Ed. 2d 158, 105 S. Ct. 1238 (1985) 54a

Gonick v. Drexel Burnham Lambert Inc., Fed. Sec. L. Rep. (CCH) ¶ 94,127 (Dec. 1988) .....

Kelly v. Einbinder [1989-90 Transfer Binder], Fed. Sec. L. Rep. (CCH) ¶ 94,963 (1990) .....

Letizia v. Prudential-Bache Sec. Inc., 802 F.2d 1185 (9th Cir. 1986) 18a

Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 74 L.Ed. 2d 765, 103 S. Ct. 927 (1983) 18a, 47a, 54a, 61a

Nesslage v. York Sec. Inc., 823 F.2d 231 (8th Cir. 1987) ...

Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 18 L.Ed. 2d 1270, 87 S. Ct. 1801 (1967) ... 6a, 11a, 12a, 62a

Rodriguez de Quijas v. Shearson/American Express Inc., 490 U.S. ____, 104 L.Ed. 2d 526, 109 S. Ct. 1917 (1989) 18a, 47a, 55a

Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 96 L.Ed. 2d 185, 107 S. Ct. 2332 (1987) .. 18a, 47a, 54a, 60a

TABLE OF AUTHORITIES

State Cases

Page

Berman v. Dean Witter & Co., 44 Cal. 3d 999, 119 Cal. Rptr. 130 (1975) .....

Ford v. Shearson/American Express, 180 Cal. App. 3d 1011, 225 Cal. Rptr. 895 (1986) 10a, 12a

Green v. Mt. Diablo Hosp. Dist., 207 Cal. App. 3d 63, 254 Cal. Rptr. 689 (1989) .....

Rice v. Dean Witter Reynolds, Inc., 1 Cal. Rptr. 265 (1991)

Strotz v. Dean Witter Reynolds, Inc., 223 Cal. App. 3d 208, 272 Cal. Rptr. 680 (1990) 8a

Tonetti v. Shirley, 173 Cal. App. 3d 1144, 219 Cal. Rptr. 616 (1985) 19a, 47a, 54a, 60a

Van Luven v. Rooney Pace, 195 Cal. App. 3d 1201, 241 Cal. Rptr. 248 (1987) .....

Federal Statutes

9 U.S.C. § 2 (1982) .....

State Statutes

Cal. Code Civ. Proc. § 128.5 ..... 8a, 12a, 53a

Cal. Code Civ. Proc. § 128.5(2)(a) .....

Cal. Code Civ. Proc. § 1281.4 .....

III.

LEGAL ARGUMENT

A. THE FEDERAL ARBITRATION ACT REQUIRES THAT THE COURT ENFORCE THE PARTIES' AGREEMENT TO ARBITRATE CONTROVERSIES.

The issue of whether an agreement to arbitrate is valid is determined by federal law. *See Shearson/American Express, Inc. v. McMahon,* 482 U.S. 220, 96 L.Ed. 2d 185, 107 S. Ct. 2332 (1987); *see also Letizia v. Prudential-Bache Sec. Inc.,* 802 F.2d 1185, 1187 (9th Cir. 1986). Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2 (1982), provides that a contract involving interstate commerce and containing an arbitration clause shall be enforceable, "save upon such grounds as exist at law or in equity for the revocation of any contract." As the transactions for the plaintiffs' account involve national securities exchanges, this is a contract evidencing a transaction involving commerce. *Cohen v. Wedbush, Noble, Cooke, Inc.,* 841 F.2d 282, 284 (9th Cir. 1988).

Two recent opinions of the U.S. Supreme Court have reaffirmed the strong federal policy in favor of arbitration. *Shearson/American Express, Inc. v. McMahon, supra; Rodriguez de Quijas v. Shearson/American Express Inc.,* 490 U.S. ____, 104 L.Ed. 2d 526, 109 S. Ct. 1917 (1989). The Supreme Court stated in *McMahon:*

> The Arbitration Act thus establishes a federal policy favoring arbitration, *Moses H. Cone Memorial Hosp. v. Mercury Const. Corp.,* 460 U.S. 1, 74 L.Ed. 2d 765, 103 S. Ct. 927 (1983), requiring that we vigorously enforce agreements to arbitrate.

470 U.S. 213, 221 (1985). In an earlier decision, the Court stated:

> Section 2 is a Congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary. . . . The Arbitration Act establishes that, as a matter of federal law, *any doubts concerning the scope of arbitratable issues*

> *should be resolved in favor of arbitration,* whether the problem at hand in the construction of the contract language itself or an allegation of waiver, delay or like defense to arbitrability.

Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., supra, 460 U.S. at 24-25).

The Ninth Circuit Court of Appeals has held that, on issues of arbitration, federal law preempts state law. *Bayma v. Smith Barney, Harris Upham & Co.,* 784 F.2d 1023, 1025 (9th Cir. 1986). California courts have also recognized that federal law preempts state law on issues of arbitrability. *Tonetti v. Shirley,* 173 Cal. App. 3d 1144, 1148-50, 219 Cal. Rptr. 616, 618-20 (1985).

GILBERT R. SEROTA, STATE BAR NO. 75303
HOWARD, RICE, NEMEROVSKI, CANADY,
ROBERTSON & FALK
A Professional Corporation
Three Embarcadero Center, 7th Floor
San Francisco, California 94111
Telephone: 415/434-1600

Attorneys for Defendant
Sutro & Co., Incorporated

SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF VENTURA

ROBERT A. LYNCH, BETTY LAVERNE LYNCH, individually and as TRUSTEES OF THE ROBERT A. LYNCH AND BETTY LAVERNE LYNCH FAMILY TRUST DATED MAY 30, 1979,

Plaintiffs,

VS.

CRUTTENDEN & COMPANY, TALLEY MCNEIL & COMPANY, INC., SUTRO & CO., INC., ROBERT C. CARTY, JR., SUN LIFE ASSURANCE COMPANY OF CANADA, SUN FINANCIAL GROUP, LOOMIS SAYLES & CO., DOES 1 through 100, inclusive,

Defendants.

Case No. 119524

DEFENDANT SUTRO & CO., INCORPORATED'S PETITION TO COMPEL ARBITRATION AND MOTION TO STAY FURTHER PROCEEDINGS IN THIS ACTION

Date: March 12, 1992
Time: 3:30 p.m.
Courtroom: 30

Petitioner Sutro & Co., Incorporated ("Sutro"), pursuant to Code of Civil Procedure Sections 1281.2 and 1292.4, petitions this Court for an order pursuant to Sections 3 and 4 of the Federal Arbitration Act (9 U.S.C. §§ 3,4), compelling Plaintiffs to arbitrate all claims asserted in their Complaint against Sutro, and for an order staying further proceedings in this action until such arbitration has been concluded. Sutro alleges as follows:

1. On or about February 27, 1989, Plaintiffs Robert A. Lynch and Betty Laverne Lynch, signed a written Client Agreement. A true and correct copy of that agreement is attached to the Declaration of Gilbert R. Serota filed herewith as Exhibit A which provides in paragraph 9 that:

> "... all controversies which may arise between you and us concerning any transaction or the construction, performance, or breach of this or any other agreement between you and us, whether entered into prior, on or subsequent to the date hereof, shall be determined by arbitration. ..."

2. On or about April 5, 1989, Plaintiffs signed a written "Client Agreement-Fee in Lieu of Commission." A true and correct copy of that agreement is attached to the Declaration of Gilbert R. Serota filed herewith as Exhibit B which provides that:

> "Client agrees that any dispute arising out of the services described in this Agreement shall be resolved by arbitration before the National Association of Securities Dealers, Inc. on the New York Stock Exchange."

3. The "Client Agreement-Fee in Lieu of Commission" was temporarily amended on December 8, 1989. A true and correct copy of the Amendment is attached to the Declaration of Gilbert R. Serota filed herewith as Exhibit C.

4. On or about July 28, 1989, Plaintiffs signed a written Option Agreement. A true and correct copy of that agreement is attached to the Declaration of Gilbert R. Serota filed herewith as Exhibit D which provides that:

> "... all controversies which may arise between us concerning any transaction or the construction, performance, or breach of this or any other agreement between us, whether entered

into prior, on, or subsequent to the date hereof, shall be determined by arbitration."

5. Based on Plaintiffs' Complaint, in or after 1989, a controversy arose between Sutro and Plaintiffs concerning Plaintiffs' securities transaction and investment relationship with Sutro.

6. The controversy, as alleged by Plaintiffs, is as follows: Defendants made certain false representations and withheld certain material facts regarding Plaintiffs' accounts and handled Plaintiffs' accounts in such a manner as to effectuate a profit for its own gain in a manner which subjected Plaintiffs to high investment risks and resulted in breaches of contract and fiduciary duty.

7. On January 31, 1992, Sutro requested Plaintiffs to arbitrate in accordance with the terms of the above-mentioned Client Agreement, Client Agreement-Fee in Lieu of Commission, and Option Agreement, but Plaintiffs have refused to do so by failing to respond to Sutro's request. Subsequently, on February 7, 1992, Sutro elected the New York Stock Exchange as the arbitral forum, as it was entitled to do pursuant to the terms of the agreement when Plaintiffs failed to respond.

8. The arbitration agreements herein alleged require that Sutro and Plaintiffs arbitrate such controversy in its entirety.

WHEREFORE, Petitioner Sutro prays:

1. That the Court order Plaintiffs to arbitrate the said dispute as alleged in the Complaint before the New York Stock Exchange;

2. For an order staying all proceedings in this action pending determination of this petition and, if granted, pending arbitration of the controversy herein alleged; and

3. For such other and further relief as the Court deems appropriate.

DATED: February 20, 1992.

GILBERT R. SEROTA
HOWARD, RICE, NEMEROVSKI,
CANADY, ROBERTSON & FALK
A Professional Corporation

By _____
GILBERT R. SEROTA
Attorneys for Defendant
Sutro & Co., Incorporated

SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF VENTURA

ROBERT A. LYNCH, BETTY LAVERNE LYNCH,
individually and as TRUSTEES OF THE ROBERT A. LYNCH AND
BETTY LAVERNE LYNCH FAMILY TRUST
DATED MAY 30, 1979,
Plaintiffs,

vs.

CRUTTENDEN & COMPANY, TALLEY MCNEIL & COMPANY,
INC., SUTRO & CO., INC., ROBERT C. CARTY, JR.,
SUN LIFE ASSURANCE COMPANY OF CANADA,
SUN FINANCIAL GROUP, LOOMIS SAYLES & CO., DOES 1
through 100, inclusive,
Defendants.

Case No. 119524

Courtroom 43

Hon. EDWIN M. OSBORNE, Judge

REPORTER'S TRANSCRIPT OF PROCEEDINGS
Wednesday, February 19, 1992

APPEARANCES:

For Plaintiffs: GOLDENRING & GOLDENRING
BY: PETER A. GOLDENRING
6050 Seahawk Street
Ventura, California 93003

For Defendants:
KEESAL, YOUNG & LOGAN
BY: DAWN M. SCHOCK
Catalina Landing
310 Golden Shore
Long Beach, California 90801-1730

RHONDA JEFFREY, CSR 5364
Official Reporter Pro Tempore
800 South Victoria Avenue
Hall Of Justice, Room 313
Ventura, California 93009

Journal, *Mago v. Shearson Lehman Hutton.* It is a Ninth Circuit case, but it reemphasizes again the rule in *Prima Paint.* If the fraud alleged goes to the inducement of the contract as a whole as opposed to the arbitration clause within the contract, then that is an issue which must be referred to arbitration.

Now, the way the plaintiffs have presented their argument in light of the *Strotz* case really goes against the rule in *Prima Paint.*

THE COURT: I hear what you are saying if the Ninth Circuit is interpreting — is stating correctly the rule. But when I look back at *Strotz* and *Rice*, I can't distinguish the type of allegation that was held sufficiently.

MS. SCHOCK: But I think that the *Mago* case stands for the proposition that *Strotz* interpreted, as the plaintiffs in this case interpreted, that is that they are alleging that the fraud went to their signing the nine agreements, that that interpretation of *Strotz* has been preempted by federal law and it is not valid.

Now, the only way *Strotz* and *Rice* can make sense is that if the fraud is so severe the plaintiff is so beguiled as to not understand the act of contracting itself. That is made most clear in *Rice* where Mrs. Rice was actually told that what she was signing was not a contract for arbitration services.

THE COURT: I am familiar with the facts. It may be that the Ninth circuit case which I have not read is correct, but it is not binding on this court. And *Strotz* and *Rice* I think are right or wrong. So I don't think it does me any good or anyone else any good to further analyze those.

As I say, the motion to compel arbitration and stay proceedings is denied.

MR. GOLDENRING: I will give notice, Your Honor, because there are other people who were served, but have not appeared yet.

MS SCHOCK: Thank you, Your Honor. At one point the parties were discussing limited discovery as to the arbitration question itself. Since that is the only issue that is before the court at this time, we would propose that discovery —

THE COURT: Let me address that in this way. I believe what is before the court is whatever *Strotz* and *Rice* say the issues are as far as fraud in the inception. But I am not prepared in advance to start trying to give an outline as to what does and does not fit within that. If that, as I rather suspect, becomes a matter of contention, that will require more than my sitting here and winging it for guidance.

MR. GOLDENRING: Just for the record, Your Honor, it's our view that the entire case is before the court until some bifurcated proceeding occurs.

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT

ROBERT A. LYNCH, BETTY LAVERNE LYNCH, individually and as TRUSTEES OF THE ROBERT A. LYNCH AND BETTY LAVERNE LYNCH FAMILY TRUST DATED MAY 30, 1979,
Respondents,

vs.

CRUTTENDEN & COMPANY, TALLEY MCNEIL & COMPANY, INC., SUTRO & CO., INC., ROBERT C. CARTY, JR., SUN LIFE ASSURANCE COMPANY OF CANADA, SUN FINANCIAL GROUP, LOOMIS SAYLES & CO., DOES 1 through 100, inclusive,
Appellants.

No. _____
Superior Court
No. 119524

APPEAL FROM THE SUPERIOR COURT
OF VENTURA COUNTY
HONORABLE STEVEN Z. PERREN
JUDGE PRESIDING
REPORTER'S TRANSCRIPT ON APPEAL

APPEARANCES:

For the Respondents:
GOLDENRING & GOLDENRING
BY: PETER A. GOLDENRING
Attorney at Law
6050 Seahawk Street
Ventura, California 93003

For the Appellants:
HOWARD, RICE, NEMEROVSKI, CANADY, ROBERTSON & FALK
BY: GILBERT R. SEROTA
Attorney at Law
Three Embarcadero Center,
7th Floor
San Francisco, California 94111

SHARON LINDLEY LEWIS, CSR 6822
Official Reporter
800 South Victoria Avenue
Suite 313
Ventura, California 93009

Volume I of I
Pages 1 through 18

SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF VENTURA

HON. STEVEN Z. PERREN, JUDGE

ROBERT A. LYNCH, et. al.,
Plaintiffs,
vs.
Cruttenden & Company, et. al.,
Defendants.

COURTROOM 22
No. 119524

REPORTER'S TRANSCRIPT ON APPEAL
Thursday, March 12, 1992

APPEARANCES:

For the Plaintiffs: PETER GOLDENRING
Attorney at Law

For the Defendants: GILBERT SEROTA
Attorney at Law

Reported by: SHARON LINDLEY LEWIS, CSR 6822
Official Reporter
800 South Victoria Avenue
Room 313
Ventura, California 93009

VENTURA, CALIFORNIA
THURSDAY, MARCH 12, 1993
AFTERNOON SESSION

THE COURT: Lynch vs. Cruttenden, et al. Tentative is to deny the motion to compel arbitration and to do so based upon a statement that could not have been made better than, "Gee, if all it takes is an allegation of this nature, then everybody can avoid arbitration," and the answer is you're absolutely right.

MR. SEROTA: May I address that, your Honor?

THE COURT: You may.

MR. SEROTA: I'm Gil Serota, representing Sutro & Company, the moving party.

Your Honor, we move to compel arbitration on the basis of three contracts and a fourth written document which amends one of the prior contracts, and I put those in evidence through my declaration, my authentication of that which is consistent with Evidence Code 400. There's been no denial by the Lynchs that they signed all those contracts.

THE COURT: Then you want a motion for summary judgment on the issue, essentially, don't you?

MR. SEROTA: Pardon me?

THE COURT: Isn't this then a motion for summary judgment?

MR. SEROTA: On arbitration?

THE COURT: Uh-huh.

MR. SEROTA: Typically, your Honor, under the Federal Arbitration Act as well as California Code of Arbitration Procedures these things are handled as law and motion matters with a petition to compel, which is what we filed, accompanied by a noticed motion for hearing.

THE COURT: Okay. As I understand it, then, if I deny your motion then the trial is had, almost a bifurcated trial issue. The fact that I deny your motion doesn't necessarily mean that the entirety of the contract becomes a matter of the state court, but

rather the first issue tried for whatever trial judge managing it would be the issue of fraud in the inception or however it's characterized. I think that's the most recent phrase that's used.

You try that issue, and it seems to me that issue can be framed on motion for summary adjudication or summary judgment, if it's based upon your declarations and there's a factual issue, if there's fraud in the inducement, I have by declarations under penalty of perjury an allegation by both of the plaintiffs to the effect that were induced into this.

Hey, somebody got it right. There's no sense in avoiding that. And once you get to that point there has to be a factual adjudication of the issue. They swear under penalty of perjury they were led down the primrose path and induced to sign something they didn't know to be a contract.

You know, if I'm sitting here looking at this, I'm a bit cynical that a man who runs a cement business and has a 5 million dollar business was led down the primrose path. I think it's a hoak. But, you kow what, I can't make that finding on this record and I don't think I'm permitted to. He makes a declaration that put it in the declaration of the State Court. It may be true, but that's a decision of fact and that's beyond the declarations that I have before me.

MR. SEROTA: If I could, that's exactly the point I'd like to address for just a moment, if I could.

THE COURT: Go ahead.

MR. SEROTA: I think the Court — First of all, you correctly identified the procedural context that we're in and what will happen, as I understand it, if the motion is denied and there's no appeal that overrules it.

The question before the Court, as I understand it, then, is are these declarations sufficient under Federal law and under the California State Court law, which is interpreting Federal law, to avoid arbitration at this stage and that's the point I want to address, because I don't think they are.

THE COURT: Go ahead.

MR. SEROTA: We all agree the Federal law controls I think and we certainly agree Strotz and Rice says that and we all also agree that Federal law compels a presumption in favor of arbitration, and if there are any doubts that those are in favor of arbitration.

The question then becomes, if you have contracts in front of you what do they have to allege to get back into court for at least the determination of fraud in the inception? There's two things — there's two things that I think get you into court, and I don't think they've alleged either one in any reasonable or particular way. Number one is if you read Prima Paint and read Strotz —

THE COURT: Didn't read Prima but studied Strotz.

MR. SEROTA: Strotz says that an allegation of a fraudulent scheme in general is not enough.

THE COURT: True.

MR. SEROTA: You have to allege fraud in the agreement to arbitrate itself. That's one way.

THE COURT: Not exactly.

MR. SEROTA: Well —

THE COURT: If I —

MR. SEROTA: At Strotz in the Cal.App.3d that I have, Page 214 it says,

> "The issue of fraud is to be decided by the Court only where it is alleged the arbitration agreement itself was obtained by fraud or is part of a fraudulent scheme. It is not sufficient to allege simply that the arbitration agreement is located in a contract which was otherwise procured by fraud."

And that's in the middle of middle paragraph, Page 214. Here there is —

THE COURT: I'm looking at Page 214. Are you talking about the paragraph with the word, "thus"?

MR. SEROTA: Yes. And if you look at the second sentence it begins with the issue of fraud.

THE COURT: But you have to read that. You're not reading the whole paragraph. You're construing Prima Paint but the key language is 218, Head Note 3, that's the key line.

MR. SEROTA: Well, I want to address the Court's attention to the analysis that gets you there, because I agree the head note says, "Allegations of fraud in the inception."

THE COURT: I didn't read just the head note, I read the text. Judge is supposed to do more.

MR. SEROTA: I agree with it. What we're talking about at this point in time is what the allegation of fraud in the inception that gets you this far.

THE COURT: Here the allegation made by the Lynchs under their declaration is Mr. Carty wormed his way into their confidence; having done so, put himself in a position having known they were about to retire, when in a moment of weakness the plaintiff said, "You know, I've been thinking of what to do with my five million."

Mr. Carty, well schooled in the oily practice of the securities exchange says, "I have a plan for you. Here, let me have your money and I'll take care of it. Just sign these meaningless documents." That's Mr. — plaintiff's allegations.

MR. SEROTA: In fact, what they say is the documents were standard and a formality. That's what's — I want the Court to focus on that for a second.

THE COURT: Go ahead.

MR. SEROTA: The first way I see these cases saying you get out of arbitration if you were induced to enter arbitration agreement by fraud. That's where somebody says there's no arbitration agreement in here. Don't worry. Sign it. That's not this case.

THE COURT: Correct.

MR. SEROTA: Okay. Question then is fraud in the inception, and what does that mean, and therefore what do you have to allege?

THE COURT: Uh-huh.

MR. SEROTA: In all these cases, Lynch, Strotz and Ford, what it means is that the person did not know that he was even entering a contract that's —

THE COURT: That's basically true.

MR. SEROTA: Okay.

THE COURT: Or if he knew he was entering a contract, it wasn't a contract for anything he knew about it.

MR. SEROTA: In Rice they describe Ford and they say the promisore is deceived as to the nature of his act.

THE COURT: Right.

MR. SEROTA: Does not know what he was signing, did not intend to enter into a contract.

THE COURT: Right.

MR. SEROTA: Okay. Now, I do not believe that in these declarations of the Lynchs you will see anything that says that when they signed the contracts with Sutro on four different dates, on four different occasions they didn't know that they were entering into a contract. Because they say they were told it was a formality, they were told it was standard, but they don't say that we didn't believe that there was a contract, and even if they did it would be rebutted by the letter that we produced as Exhibit 3 or Exhibit C to my declaration, because in Exhibit C —

THE COURT: Just a second. Bear with me. Here we are. Yes.

MR. SEROTA: Exhibit C is a letter.

THE COURT: Uh-huh.

MR. SEROTA: Doesn't contain any hidden anything. It says to temporarily amend our client agreement.

THE COURT: Uh-huh.

MR. SEROTA: Now, how is it that someone could sign something that amends something else whose only purpose is to amend something else and claim that they didn't know they were entering into a contract or had entered into a contract.

THE COURT: And the answer is I haven't a clue. That's what the contract trial is going to be about.

MR. SEROTA: But they haven't alleged — my point is, your Honor, that they have not alleged in their papers that they were deceived as to the nature of this document. They don't even address this document in their papers. They don't even explain it. They don't even make the initial showing that would get them out of arbitration.

To get them out of arbitration they would have to say and explain in some kind of particularized way how they could sign four separate dates, four separate documents and not know they're entering into a contract. That's not in their declaration, and that's why I don't think they've made the showing that is required under a fair reading of Strotz and Rice when put into context with Federal law.

Because fraud in the inception just doesn't mean that I say this whole thing was part of a general fraudulent scheme. You've got to say that I either — the specific agreement to arbitrate was fraudulently induced, which they don't or I didn't know I was signing any contract at all, which they don't.

Now, these things may well have been formalities, they may well have been standard, but that doesn't mean they didn't know they were signing a contract.

And if a declarant doesn't explain in his opposition to the motion, how this letter could have come about amending a contract, he doesn't meet the burden to get over the presumption of arbitration, and that's why I think it would be wrong to read Strotz and Rice so broadly that all they have to do is allege, as you said, a broad scheme of trust and reliance and I was told it was a formality because that's not enough.

That puts you in Prima Paint. That puts you in what Strotz said is if it's a general fraudulent scheme it's for the arbitrator. If it's

specific to the arbitration agreement that's for the judge, and then there's this fraud in the inception which is like Mrs. Rice. Mrs. Rice thought she was making a loan. I mean there's no allegation of that here. They knew they were investing their money with Sutro. They hoped they weren't signing their life away, but nobody says they were signing their life away. Okay.

In Ford, the other case they rely on, the poor man had given blank checks and credit cards and bill paying authority and all the rest to the guy who induced him to enter into this agreement. That's not this case.

And so my point is that to avoid the exception undermining the rule, you've got to take an approach that says do they really meet this standard, do they really prove or allege in their declarations fraud in the inception. And I don't think there's anything in their declarations that say I didn't know I was contracting. I didn't know I was entering into a formal relationship. They say standard and formal. Again, I don't think that's enough.

That's really our point on this, and I would just urge the Court, and maybe you don't have copies — I can hand them up. Cohen vs. Wedbush, Noble and Cooke, Ninth Circuit case said it's not enough to allege, for example, that the arbitration agreement was undisclosed or that it was adhesive or unconscionable. That doesn't get you a separate trial on fraud and Hurlbut case from the District of Massachusetts is the same thing.

It's not enough to say I wasn't allowed to read it, wasn't given legal advice, it wasn't explained to me. That doesn't get you in fraud in the inception or to a separate trial on the issue of arbitration, and that's where I think the failing is in this case and in the generalized declarations.

And I would be happy to hand those federal cases up to the Court if you'd like to look at them.

MR. GOLDENRING: If I might respond, your Honor.

THE COURT: You may.

MR. GOLDENRING: What counsel is attempting to do is make this the summary judgment motion or bifurcated trial.

A reading of Strotz and Rice made clear that all that is at issue now is whether there is an allegation and if there is an allegation then the petition is denied. At that point, at the defendant's election they can seek the bifurcated trial or not if they choose. That's then their choice.

The argument of counsel is essentially identical to that which was placed before Judge Osborne by Talley McNeil and Cruttenden. The Sutro documents were before Judge Osborne in the petition.

If you look at the original basically Mr. Carty was Sutro, started the relationship, moved over to Talley McNeil, which became Cruttenden, and took the Lynchs along with him, and all of the documents were before Judge Osborne in the Talley McNeil, Cruttenden petition and the identical argument was made.

What the argument really is when you cut through the niceties of language of counsel is that if there's an understanding that there's a business relationship then *ipso facto* arbitration follows. Unless someone can claim that they don't have any basis to understand that there's a business relationship, then they are required to proceed to arbitration.

In Strotz the language is very clear of the Court each time. According to plaintiff, defendants advised her that these, the documents being presented were simply standard forms required for her act and there was nothing to worry about. She also stated in her declaration that she signed these — this document in reliance on defendant's assurances that these documents were merely standard forms.

In Rice, again, she's presented standard forms and both context. There's no allegation by the plaintiff that they didn't know that there was a business relationship occurring.

To interpret Strotz and Rice in that fashion is to essentially gut them. What both of those cases talk about is that in the context of the fiduciary relationship is there the allegation that meets either the inception or permeation theory, and I don't want to lose sight of the fact that both theories exist in California law and they have

not been reconciled as specifically articulated in the Rice case that they rule only on inception.

THE COURT: Permeation seems to be in its death row in all candor.

MR. GOLDENRING: I'm not disagreeing, but specifically the Rice court, the latest articulation makes clear it is not ruling on the permeation doctrine and simply on the inception.

What is critical it seems to me, your Honor, is the language of the Court in its holding in Strotz because there's no ambiguity in that holding and counsel's articulations to the contrary.

It is not Federal law by which what we measure the allegation — by which we measure the allegation. The fact that a Federal court back east or Ninth Circuit is talking about what they think the Federal Arbitration Act means is irrelevant, because none of those cases talk about California law which is the measure under Strotz and Rice.

In Strotz the Court says, without any limitations as to the nature of the relationship it says:

> "Accordingly, we hold absolutely, we hold that allegations of fraud in the inception or execution of a contract which contains an agreement to arbitrate are sufficient to place the issue of fraud before the Court and deny a petition to compel arbitration."

Here the plaintiff has alleged that the —

THE COURT: I've got that.

MR. GOLDENRING: That's where we're at, and as much as defendants want — and I mean it's the argument that I heard in front of Judge Osborne. As much as they want to try to narrow those cases, the holdings of those cases are not narrow at all.

Once the allegation is made then the matter is a triable issue of fact in the context of the fiduciary relationship that exists and that's a determination that occurs in the bifurcated trial if that's what the defendants choose to proceed with. That's their option once the Court denies the motion, if the Court so chooses.

There is no language that narrows either Strotz or Rice in their holdings to the blind, deaf, dumb person who doesn't even know that they're signing a document. That's not what those cases hold and that's not what the facts are. In both cases they were standard documents and both cases they were told, don't read them, don't worry, they're just standard formalities for us to take care of you.

And what has occurred in this case is my clients were presented with various documents at various points in time in the context of this, and that's what occurred, and our allegations, your Honor, are sufficient indeed under Strotz.

It is probably true that the allegations in the Complaint alone are sufficient if the Complaint had been verified, because the Court talks in Strotz about allegations in the complaint as well as by declaration, but I present both so that this Court has a feeling not just from the pleading what its nature is but also as to the nature of its relationship so the Court has some depth in terms of it, but the measure of the depth, or the truthfulness of the declarations or the believability of my clients or the weighing of that evidence is not what occurs today.

Once the allegations are married that's enough for us to go to the next step, which is the trial on the bifurcated proceeding where a trier of fact makes those determinations.

MR. SEROTA: Your Honor, four brief points to make in rebuttal.

First of all, let me address Strotz. We, all three of us read the words that have been quoted by you, by Mr. Goldenring and myself, but that's conclusion allegations of fraud in the inception. The question is are there allegations of fraud in the inception that are sufficient to get past this motion.

In Strotz at the bottom of 317 is where they define what is fraud in the inception, which is we agree that if a party is unaware he is signing any contract, obviously he also is unaware he is agreeing to arbitration. I think that's the definition of fraud in the inception and I certainly —

Strotz was clarified by the Court in Rice which clearly stated that fraud in the inception is someone who is deceived as to the

nature of her act and actually did not know what she was signing. Again, there a loan agreement masquerading as a contract. That's point one.

THE COURT: Other way around I think.

MR. SEROTA: They were — she thought it was a loan agreement. Okay.

Point two is: The statement that you should ignore Federal cases in making this determination. Okay. I think that's clearly wrong.

And in Moses Cone vs. Mercury Construction, United States Supreme Court, addressing Section 2 of the Federal Arbitration Act, which is what we've invoked here, says that Section 2 is a congressional declaration of a liberal Federal policy favoring arbitration agreements notwithstanding any state substantive or procedural policies to the contrary. The effect of the section is to create a body of Federal substantive law applicable to any arbitration agreement within the coverage of the act. That doesn't allow counsel's argument that you can ignore Federal law.

The final point is, if you follow Federal law and you look at the Ninth Circuit case in Cohen vs. Wedbush, Noble and Cooke, there the Cohens say they were never advised that the margin agreement compromised any of their rights. That's the allegation. The Ninth Circuit says:

> "Even assuming the dubious proposition that an implicit statement regarding a question of law can be fraud, this is not fraud in the inducement of the arbitration agreement, and this allegation goes to arbitration."

So where I come out again on this is in the — taking their declarations at face value, as I think you need to, there is not an allegation that they were fraudulently induced to enter the arbitration agreement itself. No one lied about its existence or nonexistence or anything.

THE COURT: I think that's where we part. That's exactly what can be gleaned from this starting at Page 7, Line 2 and running through Page 8, Line 12.

MR. SEROTA: They said they didn't know.

THE COURT: They start off by saying, "We were told ignore these documents. They're mere formalities. Just give us the signature. Don't worry about them." They worry on the fiduciary, whom they place trust and hope, and unbeknownst to them contained in the documents that they were told expressly to ignore was language, which had they known it was there they would have never signed and specifically intended not to waive.

I think it gets it.

MR. SEROTA: Cohen vs. Wedbush, Noble and Cooke says no way on that, exactly on that. It says that requiring reasonable investigation by the parties claiming fraud is appropriate in cases where the explicit language of the contract directly contradicts the alleged misrepresentation.

We see no unfairness in expecting parties to read contracts before they sign them, and that this reasoning is particularly pervasive in the context of arbitration clauses where permitting plaintiffs to present their claims to a jury would frustrate the very policies these clauses and the arbitration act itself are meant to promote, the very thing we were induced not to read this. We were told that this didn't compromise our rights is absolutely rejected by the Ninth Circuit and they're sent to arbitration. That's Federal law.

And quite frankly I still don't think that's inconsistent with Strotz and Rice, because I don't think that that's fraud in the inception. I don't think your failure to read or even being induced not to read an entire agreement is fraud in the inception.

Fraud in the inception is don't worry, it's not a contract. Don't worry, it's only a loan agreement or it's a receipt, you know, this is your receipt. They don't say that. And I know perhaps I'm hitting myself — my head against a brick wall at this point but I think —

THE COURT: I've been called other things in my time.

MR. SEROTA: But the ruling itself being a brick wall. But I think that read in the context of what Strotz and Rice stand for in

terms of fraud in the inceptions, these declarations don't make it and obviously they can't make it or they would have made it.

In other words, if they were told, you're not signing a contract, this doesn't have to do with a relationship between us, it's a receipt or it's something else, they would have said that in the declarations, they don't.

And I would just respectfully ask your Honor to take one more look at this perhaps before making a final decision. Thank you.

THE COURT: Actually I spent about, cumulative time about two hours on this file.

MR. SEROTA: I didn't mean to imply that you had not.

THE COURT: I didn't understand that to mean that. And I did it because I as utterly ignorant of the subject area.

But the only thought that comes to my mind you have my sympathy but not my ruling. I think that what Strotz has done is to eviserate the rule. I think it's a terrible case. I think it's a bad law and counter to public policy and I think it tries to abrogate the Federal rule. I can give you a list of reasons.

I think it is the, for whatever reason, a means by which the state courts have tried to usurp Federal prerogative. And there's some good reasons for that. I think they were principally brought about if I — I think it was the paint case, because under these agreements not only did they go this far but moved people in different jurisdictions where they couldn't protect themselves, and that's probably where this thing found its genesis and at its inception had pretty good reason. This is all by way of dicta at best, but I read it and was surprised at the language.

It does do exactly what you said it can do, but I think you're absolutely correct. I think that's exactly what the plaintiffs can do. I think they're going to be hard pressed to prevail. Mr. Goldenring's protestations to the contrary notwithstanding I think he's got a tough road to hoe in this case. But if he wants to lengthen it out and pick up that hoe, I guess that's his right.

Motion is denied.

MR. GOLDENRING: Your Honor, I'll give notice. There are other parties.

THE COURT: Please. This one will go up on appeal with its companion.

MR. SEROTA: We haven't made that determination.

THE COURT: I thought I saw a Notice of appeal.

MR. SEROTA: Cruttenden has appealed and we have not decided that.

MR. GOLDENRING: Also a third defendant not subject to the arbitration clause, the insurance company who's answered. So it's going to be an interesting case procedurally.

I'll give because of all the different players.

THE COURT: Thank you.

(Proceedings concluded for the day.)

REPORTER'S CERTIFICATE

STATE OF CALIFORNIA
COUNTY OF VENTURA } ss.:

I, SHARON LINDLEY LEWIS, CSR No. 6822, Certified Shorthand Reporter of the State of California, for the County of Ventura, do hereby certify that the foregoing, pages 1 through 18, comprise a full, true and correct transcript of the proceedings had in the above-entitled action on February 12, 1992.

Dated at Ventura, California, this 12th day of August, 1992.

SHARON LINDLEY LEWIS, CSR 6822
Official Reporter

2d Civ. No. B065198

COURT OF APPEAL, STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT, DIVISION SIX

ROBERT A. LYNCH, BETTY LAVERNE LYNCH, individually and as TRUSTEES OF THE ROBERT A. LYNCH AND BETTY LAVERNE LYNCH FAMILY TRUST DATED MAY 30, 1979,

Plaintiffs and Respondents,

vs.

CRUTTENDEN & COMPANY, TALLEY MCNEIL & COMPANY, INC., SUTRO & CO., INC., ROBERT C. CARTY, JR., SUN LIFE ASSURANCE COMPANY OF CANADA, SUN FINANCIAL GROUP, LOOMIS SAYLES & CO., DOES 1 through 100, inclusive,

Defendants and Appellants.

Ventura County Superior Court
Case No. 119524

(Hon. Edwin M. Osborne)

(Notice of Appeal Filed February 27, 1992)

APPELLANTS' OPENING BRIEF

DAWN M. SCHOCK (121746)
JOHN R. LOFTUS (126841)
KEESAL, YOUNG & LOGAN
A Professional Corporation
Catalina Landing —
310 Golden Shore
Post Office Box 1730
Long Beach, California 90801-1730
Telephone: (310) 436-2000

Attorneys for Appellants CRUTTENDEN & COMPANY, TALLEY McNEIL & COMPANY, INC., and ROBERT C. CARTY, JR.

TABLE OF AUTHORITIES

Federal Cases

Page

Alascom Inc. v. ITT N. Electric Co., 727 F.2d 1419 (9th Cir. 1984) .....

Bayma v. Smith Barney, Harris Upham & Co., 784 F.2d 1023 (9th Cir. 1986) 19a, 47a, 60a

Cohen v. Wedbush, Noble, Cooke, Inc., 841 F.2d 282 (9th Cir. 1988) 9a, 10a, 18a, 19a, 47a, 55a, 60a

Moseley v. Electronic Facilities, 374 U.S. 167, 10 L. Ed. 2d 818, 83 S. Ct. 1815 (1963) .....

Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 74 L. Ed. 2d 765, 103 S. Ct. 927 (1983) 18a, 47a, 54a, 61a

Pierson v. Dean, Witter, Reynolds, Inc. (7th Cir. 1984, 742 F.2d 334 .....

Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 18 L. Ed. 2d 1270, 87 S. Ct. 1801 (1967) 6a, 11a, 12a, 62a

Rodriguez de Quijas v. Shearson/American Express Inc., 490 U.S. 477, 104 L. Ed. 2d 526, 109 S. Ct. 1917 (1989) 18a, 47a, 55a

Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 96 L. Ed. 2d 185, 107 S. Ct. 2332 (1987) 18a, 47a, 54a, 60a

Zolezzi v. Dean Witter Reynolds Inc., 787 F.2d 1447 (9th Cir. 1986) .....

State Cases

Ford v. Shearson Lehman/American Exp., Inc., 180 Cal. App. 3d 1015, 225 Cal. Rptr. 895 (1986) 12a

Heily v. Superior Court, 202 Cal.App.3d 255, 248 Cal. Rptr. 673 (1988) .....

Main v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., Cal. App.3d 19, 136 Cal. Rptr. 378 (1977) 8a

TABLE OF AUTHORITIES

State Cases

Page

Rice v. Dean Witter Reynolds, Inc., 235 Cal.App.3d 1016, 1 Cal. Rptr. 2d 265 (1991) 8a, 13a

Rowland v. Paine Webber, Inc., 92 Daily Journal D.A.R. 3353 (1992) 9a, 13a, 47a, 48a, 55a, 60a

Stansfield v. Starkey, 220 Cal.App.3d 59, 269 Cal. Rptr. 337 (1990) .....

Strotz v. Dean Witter Reynolds, Inc., 223 Cal.App.3d 208, 272 Cal. Rptr. 680 (1990) 8a, 12a

Tonetti v. Shirley, 173 Cal.App.3d 1144, 219 Cal. Rptr. 616 (1985) 19a, 47a, 54a, 60a

Federal Statutes

9 U.S.C. § 1 et seq 60a

9 U.S.C. § 2 (1982) 8a, 18a, 47a, 60a

State Statutes

Code of Civil Procedure § 1294(a) .....

VII.
LEGAL ARGUMENT

A. THE FEDERAL ARBITRATION ACT REQUIRES THAT THE COURT ENFORCE THE PARTIES' AGREEMENTS TO ARBITRATE CONTROVERSIES.

It is beyond dispute that the present controversy is governed by the Federal Arbitration Act ("FAA"). 9 USC § 1 *et seq. See, Rowland v. Painewebber*, 92 Daily Journal D.A.R. 3353 (1992), *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 96 L.Ed. 2d 185, 107 S. Ct. 2332 (1987). Section 2 of the FAA provides that a contract involving interstate commerce and containing an arbitration clause shall be enforceable, "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 USC § 2 (1982). As the transactions in the Lynches' accounts involve national securities exchanges, this is a contract evidencing a transaction involving commerce. *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 284 (9th Cir. 1988).

The enactment of the FAA and the cases interpreting it emphasize the strong national policy in favor of arbitration. *Shearson/American Express, Inc. v. McMahon, supra; Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 104 L.Ed. 2d 526, 109 S. Ct. 1917 (1989). That policy is so strong that:

> *any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration*, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay or like defense to arbitrability.

Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25, 74 L. Ed. 2d 765, 103 S. Ct. 927 (1983).

Both state and federal courts have recognized that on issues of arbitration, federal law preempts state law. *Bayma v. Smith Barney, Harris Upham & Co.*, 784 F2d 1023, 1025 (9th Cir. 1986); *Tonetti v. Shirley*, 173 Cal. App. 3d 1144, 1148-50, 219 Cal. Rptr. 616, 618-20 (1985).

B. THE LYNCHES' FACTUAL ALLEGATIONS ARE INSUFFICIENT TO VITIATE THE AGREEMENTS TO ARBITRATE.

1. *The Lynches Make No Allegation That Any Statement Related to Signing the Agreements Was False.*

Since the trial court denied Cruttenden's motion to compel arbitration, this court has rendered a decision which, Cruttenden submits, is dispositive of the primary issues in this appeal.

2d Civil No. B066610

COURT OF APPEAL OF THE STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT (DIVISION SIX)

ROBERT A. LYNCH, BETTY LAVERNE LYNCH,
individually and as TRUSTEES of the
ROBERT A. LYNCH AND BETTY LAVERNE LYNCH
FAMILY TRUST DATED MAY 22, 1979
Plaintiffs and Respondents,

v.

SUTRO & CO., INC.
Appellant and Defendant.

Ventura County Superior Court
Case No. 119524
(Hon. Steven Z. Perren)
(Notice of Appeal Filed April 20, 1992)

APPELLANT'S OPENING BRIEF

GILBERT R. SEROTA
JOHN M. CHAISSON
HOWARD, RICE, NEMEROVSKI,
CANADY, ROBERTSON & FALK
A Professional Corporation
Three Embarcadero Center, 7th Floor
San Francisco, California 94111
Telephone: 415/434-1600

Attorneys for Appellant-Defendant,
Sutro & Co. Inc.

TABLE OF AUTHORITIES

Cases

Page

Alascom Inc. v. ITT N. Elec. Co., 727 F.2d 1419 (9th Cir. 1984) .....

Cohen v. Wedbush, Noble, Cooke, Inc., 841 F.2d 282 (9th Cir. 1988) 9a, 10a, 18a, 19a, 47a, 55a, 60a

Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213 (1985) 54a

Erickson, Arbuthnot, McCarthy, Kearney & Walsh, Inc. v. 100 Oak Street, 35 Cal. 3d 312 (1983) .....

Ford v. Shearson Lehman American Express, Inc., 180 Cal. App. 3d 1011 (1986) 10a, 12a

Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 67 Cal. App. 3d 19 (1977) 8a

Moseley v. Electronic & Missile Facilities, 374 U.S. 167 (1963) .....

Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1 (1983) 18a, 47a, 54a, 61a

Perry v. Thomas, 482 U.S. 483 (1987) 54a, 61a

Pierson v. Dean Witter Reynolds, Inc. 742 F.2d 334 (7th Cir. 1984) .....

Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967) 6a, 11a, 12a, 62a

Rice v. Dean Witter Reynolds, Inc., 235 Cal. App. 3d 1016 (1991) 8a, 13a

Rodriguez de Quijas v. Shearson/American Express Inc., 490 U.S. 477 (1989) 18a, 47a, 55a

Rowland v. Paine Webber, Inc., 4 Cal. App. 4th 279 (1992) 9a, 13a, 47a, 48a, 55a, 60a

Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987) 18a, 47a, 54a, 60a

Southland Corp. Keating, 465 U.S. 1 (1984) 54a, 60a, 61a

Standfield v. Starkey, 220 Cal. App. 3d 59 (1990) .....

TABLE OF AUTHORITIES

CASES

Page

Strotz v. Dean Witter Reynolds, Inc., 223 Cal. App. 3d 208 (1990), *cert. denied*, ___ US ___, 111 S. Ct. 1417 (1991) 8a, 12a

Tonetti v. Shirley, 173 Cal. App. 3d 1144 (1985) 19a, 47a, 54a, 60a

Van Luven v. Rooney Pace, Inc., 195 Cal. App. 3d 1201 (1987) .....

Zollezzi v. Dean Witter Reynolds Inc., 789 F.2d 1447 (9th Cir. 1986) .....

Statutes and Regulations

9 U.S.C. § 2 ..... 8a, 18a, 47a, 53a, 60a

Fed. Rule Civ. Proc. 9(b) .....

Code Civ. Proc.

§ 1281.2 .....

§ 1294(a) .....

the trial court below:

> "The Court: I think that what *Strotz* has done is to eviscerate the rule. I think it's a terrible case. I think it's bad law and counter to public policy and I think it tries to abrogate the Federal rule. I can give you a list of reasons.
>
> I think it is the [sic], for whatever reason, a means by which the state courts have tried to usurp federal prerogative." (RT 17)

ARGUMENT

I.

FEDERAL LAW REQUIRES THAT ALL OF PLAINTIFFS' CLAIMS BE ARBITRATED.

A. *All of Plaintiffs' Claims Are Governed By The Federal Arbitration Act Which Required The Court To Enforce The Agreements.*

Although both the trial court and Plaintiffs' counsel treated federal arbitration law as almost an afterthought for the purposes of Sutro's motion, it is clear that the Federal Arbitration Act ("the Act") governs the present controversy and agreements to arbitrate. In enacting the Act, Congress sought to establish a federal policy in favor of the validity and enforceability of arbitration agreements which involve some aspect of commerce — such as Plaintiffs' agreements regarding securities investment. This is made clear by the language of the Act itself. Section 2 provides that:

> "A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof . . . shall be *valid, irrevocable, and enforceable,* save upon such grounds as exist at law or in equity for the revocation of any contract." (9 U.S.C. § 2(emphasis added))

Thus, an agreement to arbitrate contained in a contract which pertains to any transaction involving commerce is governed by the

Act. For these purposes, the Act preempts state law on questions of enforceability, application of the agreement, and arbitrability. *See Perry v. Thomas*, 482 U.S. 483, 489 (1987) ("Section 2, therefore, embodies a clear federal policy of requiring arbitration unless the agreement to arbitrate is not part of a contract evidencing interstate commerce or is revocable . . . ."); *Southland Corp. v. Keating*, 465 1, 11 (1984) ("We see nothing in the Act indicating that the broad principle of enforceability is subject to any additional limitations under the state law."); *Van Luven v. Rooney Pace, Inc.*, 195 Cal. App. 3d 1201, 1206 (1987) ("The act . . . preempts California law governing the validity of an arbitration clause.") *Tonetti v. Shirley*, 173 Cal. App. 3d 1144, 1147 (1985) ("Recent United States Supreme Court cases have made it clear this federal statute preempts state law on the issue of arbitrability of an agreement falling under the Act."). This preemption, and the federal policies favoring the validity of arbitration agreements embodied in the Act, will operate despite a party's attempt to invoke state policies or laws to the contrary:

> "Section 2 is a congressional declaration of a liberal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary. The effect of the section is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act. . . . The Arbitration Act establishes that, *as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration . . . .*" (*Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983) (emphasis added)).

It is this federal policy and body of substantive law of arbitrability which requires that both federal *and* state courts vigorously enforce agreements to arbitrate which fall under the Act. *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 226 (1987) (the Act requires rigorous enforcement of agreements to arbitrate); *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 221 (1985) (uncertainties must be resolved in favor of arbitration); *see also Rodriguez de Ouijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 478-83 (1989) (describing the

federal policy favoring arbitration embodied in the Act); *Rowland v. Paine Webber Inc.*, 4 Cal. App. 4th 279, 284 (1992) (same). There is no dispute that the arbitration agreements between Sutro and Plaintiffs were governed by the Act and federal law. Contracts which involve the national securities exchange are considered to be contracts involving "commerce" within the meaning of Section 2. *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 285 (9th Cir. 1988). Moreover, arbitration agreements between brokerage firms and customers have been consistently enforced under of the Act. *E.g., Byrd*, 470 U.S. at 217.

Given this backdrop of federal policies favoring arbitration and requiring that uncertainties regarding agreements which fall within the scope of the Act be resolved in favor of enforcement, it is difficult to understand the trial court's readiness to deny Sutro's motion to compel arbitration based on exceptions which the court itself admitted were attempts to usurp federal law. This decision becomes all the more surprising once the broad scope of the agreements are examined.

Sup. Ct. No. _____
2d Civ. Nos. B065198, B066610
Ventura Sup. Ct. No. 119524

IN THE
SUPREME COURT OF CALIFORNIA

ROBERT A. LYNCH, BETTY LAVERNE LYNCH,
individually and as TRUSTEES OF THE
ROBERT A. LYNCH AND BETTY LAVERNE LYNCH
FAMILY TRUST DATED MAY 30, 1979,

Plaintiffs and Respondents,

vs.

CRUTTENDEN & COMPANY, TALLEY MCNEIL &
COMPANY, INC., SUTRO & CO., INC., ROBERT C. CARTY, JR.,
SUN LIFE ASSURANCE COMPANY OF CANADA,
SUN FINANCIAL GROUP, LOOMIS SAYLES & CO.,
DOES 1 through 100, inclusive,

Defendants and Petitioners.

After Decision by the Court of Appeal,
Second Appellate District, Division Six

PETITION FOR REVIEW

DAWN M. SCHOCK (121746)
JOHN R. LOFTUS (126841)
KEESAL, YOUNG & LOGAN
A Professional Corporation
Catalina Landing
310 Golden Shore
Post Office Box 1730
Long Beach, CA 90801-1730
Telephone: (310) 436-2000

Attorneys for Petitioners
CRUTTENDEN &
COMPANY, TALLEY
McNEIL & COMPANY, INC.,
and ROBERT C. CARTY, JR.

GILBERT SEROTA (75305)
HOWARD, RICE,
NEMEROVSKI, CANADY,
ROBERTSON & FALK
A Professional Organization
Seventh Floor
Three Embarcadero Center
San Francisco, CA 94111
Telephone: (415) 434-1600

Attorneys for Petitioners
SUTRO & CO., INC.

TABLE OF AUTHORITIES

Federal Cases

Page

Arnold v. The Arnold Corp., 920 F.2d 1269 (6th Cir. 1990) 7, 13

Bayma v. Smith Barney, Harris Upham & Co., 784 F.2d 1023 (9th Cir. 1986) 19a, 47a, 60a

Bhatia V. Johnston, 818 F.2d 418 (5th Cir. 1987) 6, 15

Cohen v. Wedbush, Noble, Cooke, Inc., 841 F.2d 282 (9th Cir. 1988) 9a, 10a, 18a, 47a, 54a, 55a, 60a

Hamilton Life Ins. Co. of N.Y. v. Republic Nat'l Life Ins. Co., 408 F.2d 606 (2d Cir. 1969) 7

Jeske v. Brooks, 875 F.2d 71 (4th Cir. 1989) 7

Macchiavelli v. Shearson Hammill, 384 F. Supp. 21 (E.D. Cal. 1974) 60a

Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 103 S. Ct. 927, 74 L. Ed. 2d 765 (1983) 18a, 19a, 61a

Perry v. Thomas, 482 U.S. 483, 107 S. Ct. 2520, 96 L. Ed. 2d 426 (1987) 54a, 61a

Pierson v. Dean Witter Reynolds Inc., 742 F.2d 334 (7th Cir. 1984) 11

Prima Paint Corp. v. Flood & Conklin Mfg., 388 U.S. 395, 87 S. Ct. 1801, 18 L. Ed. 2d 1270 (1967) 6a, 11a, 12a, 62a

Republic of Nicaragua v. Standard Fruit Co., 937 F.2d 469 (9th Cir.), *cert. denied*, 117 L. Ed. 2d 516 (1991) 60a

Schacht v. Beacon Ins. Co., 742 F.2d 386 (7th Cir. 1984)

Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987) 18a, 47a, 54a, 60a

Southland Corp. v. Keating, 465 U.S. 1, 104 S. Ct. 852, 79 L. Ed. 2d 1 (1984) 54a, 60a, 61a

Stateside Mach. Co. v. Alperin, 591 F.2d 234 (3d Cir. 1979) .....

TABLE OF AUTHORITIES

FEDERAL CASES

Page

Teledyne, Inc. v. Kone Corp., 892 F.2d 1404 (9th Cir. 1990) 6, 14

Three Valleys Mun. Water Dist. v. E.F. Hutton & Co., 925 F.2d 1136 (9th Cir. 1991) 6, 14

Union Mutual Stock Life Ins. Co. of Am. v. Beneficial Life Ins. Co., 774 F.2d 524 (1st Cir. 1985) 7

Volt Info. Sys. Inc. v. Board of Trustees of the Leland Stanford Junior Univ., 489 U.S. 468, 103 L. Ed. 2d 488 (1989) 61a

Walker v. KFC Corp., 728 F.2d 1215 (9th Cir. 1984) ...

State Cases

Ericksen, Arbuthnot, McCarthy, Kearney & Walsh, Inc. v. 100 Oak St., 35 Cal. 3d 312, 197 Cal. Rptr. 581 (1983)

Ford v. Shearson Lehman/American Express Inc., 180 Cal. App. 3d 1011, 225 Cal. Rptr. 895 (1986) 10a, 12a

Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 20 Cal. App. 3d 668, 97 Cal. Rptr. 811 (1971) 11

Macaulay v. Norlander, 12 Cal. App. 4th 1, 15 Cal. Rptr. 2d 204 (1992) 10

Parr v. Superior Court, 139 Cal. App. 3d 440, 188 Cal. Rptr. 801 (1983) 10

Rice v. Dean Witter Reynolds Inc., 235 Cal. App. 3d 1016, 1 Cal. Rptr. 2d 265 (1991) 8a, 13a

Rowland v. PaineWebber Inc., 4 Cal. App. 4th 279, 6 Cal. Rptr. 2d 20 (1992) 9a, 13a, 47a, 48a, 55a, 60a

Strotz v. Dean Witter Reynolds Inc., 223 Cal. App. 3d 208, 272 Cal. Rptr. 680 (1990) 8a, 12a

Tonetti v. Shirley, 173 Cal. App. 3d 1144, 219 Cal. Rptr. 616 (1985) 19a, 47a, 54a, 60a

TABLE OF AUTHORITIES

Page

Federal Statutes

9 U.S.C. § 1, *et seq.* 60a

9 U.S.C. § 2 (1982) 8a, 18a, 47a, 53a, 60a

Docketed Cases

Lynch v. Cruttenden & Co., 93 Daily Journal D.A.R. 11395 (Sept. 2, 1993) .....

State Statutes

Code of Civil Procedure Section 1280, *et seq* .....

IV.

THIS COURT SHOULD GRANT REVIEW BECAUSE THE LOWER COURT'S INTERPRETATION OF THE "PRIMA PAINT" DOCTRINE, AS IT APPLIES TO SECURITIES ARBITRATION AGREEMENTS, IS IN DIRECT CONFLICT WITH CONTROLLING FEDERAL LAW

A. FEDERAL LAW PREEMPTS CONFLICTING STATE LAW IN THE PRESENT CASE.

It is beyond dispute that the present controversy is governed by the FAA, 9 U.S.C. § 1, *et seq. See Rowland v. PaineWebber Inc.*, 4 Cal. App. 4th 279, 6 Cal. Rptr. 2d 20 (1992); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987). Section 2 of the FAA provides that a contract involving interstate commerce and containing an arbitration clause shall be enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2 (1982); *Republic of Nicaragua v. Standard Fruit Co.*, 937 F.2d 469, 475 (9th Cir.), *cert. denied*, 117 L. Ed. 2d 516 (1991). As the transactions in the Lynches' accounts involved national securities exchanges, these are contracts evidencing a transaction involving commerce. *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 284 (9th Cir. 1988); *Macchiavelli v. Shearson Hammill*, 384 F. Supp. 21, 30 (E.D. Cal. 1974).

Both state and federal courts recognize that on issues of arbitration, federal law preempts conflicting state law. *Southland Corp. v. Keating*, 465 U.S. 1, 13, 104 S. Ct. 852, 79 L. Ed. 2d 1, 13 (1984); *Bayma v. Smith Barney, Harris Upham & Co.*, 784 F.2d 1023, 1025 (9th Cir. 1986); *Tonetti v. Shirley*, 173 Cal. App. 3d 1144, 1148-50, 219 Cal. Rptr. 616, 618-20 (1985).

As the United States Supreme Court has decreed, the pronouncement of a federal court supersedes any contrary state law:

> But even when Congress has not completely displaced state regulation in an area, state law may nonetheless be preempted *to the extent that it actually conflicts with federal law* — that is, to the extent that it "stands as an obstacle to the

> accomplishments and execution of the full purposes and objectives of Congress."

Volt Info. Sys. Inc. v. Board of Trustees of the Leland Stanford Junior Univ., 489 U.S. 468, 477, 103 L. Ed. 2d 488, 499 (1989) (emphasis added).

Since the court below relied primarily upon Section 2 of the FAA to argue that state law must be applied to the exclusion of federal law in this case, it is important to review judicial interpretations of that section:

> Section 2 [of the FAA] is a Congressional declaration of a liberal federal policy favoring arbitration agreements, *notwithstanding any state substantive or procedural policies to the contrary*. The effect of this section is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act.... [T]he Courts of Appeals have ... consistently concluded that questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration. We agree. The Arbitration Act establishes that as a matter of federal law, any doubts concerning the scope of arbitral issues should be resolved in favor of arbitration, *whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability*.

Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25, 103 S. Ct. 927, 941, 74 L. Ed. 2d 765, 785 (1983) (emphasis added).

Thus, while it is evident that the FAA does not completely occupy the field as to arbitrability, it is clear that where the federal courts have spoken, that law controls both in state and federal courts. *See, e.g., Southland Corp. v. Keating*, 465 U.S. 1, 104 S. Ct. 852, 79 L. Ed. 2d 1 (1984) (California Supreme Court overruled); *Perry v. Thomas*, 482 U.S. 483, 489, 107 S. Ct. 2520, 96 L. Ed. 2d 426 (1987) (California statute preempted).

B. UNDER FEDERAL LAW, GENERALIZED CHALLENGES TO CONTRACTS CONTAINING ARBITRATION CLAUSES MUST BE COMPELLED TO ARBITRATION.

The United States Supreme Court provided the rule which governs this issue in *Prima Paint Corp. v. Flood & Conklin Mfg.*, 388 U.S. 395, 87 S. Ct. 1801, 18 L. Ed. 2d 1270 (1967). In that case, the Court considered whether the issue of the enforceability of a contract alleged to have been fraudulently induced and which contained an arbitration provision was to be considered by a court or by arbitrators. The Court ruled that the matter was to be sent to arbitration. In so holding, the Court recognized that the arbitration clause is severable from the rest of the contract. The Court held in that regard:

> [I]f the claim is fraud in the inducement of the arbitration clause itself — an issue which goes to the "making" of the agreement to arbitrate — the federal court may proceed to adjudicate it. *But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally.*